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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1946

No. 68

BEULAH B. CRANE, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED MARCH 25, 1946.

CERTIORARI GRANTED APRIL 29, 1946.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 68

BEULAH B. CRANE, PETITIONER,

vs.

THE UNITED STATES

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

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[fol. a] **IN THE TAX COURT OF THE UNITED STATES**

Docket No. 110361

BEULAH B. CRANE, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Appearances: For Taxpayer: William R. Conklin, Esq., Edward S. Bentley, Esq., Robert W. Owens, Jr. Esq., Sperry Butler, Esq., For Comm'r.: Carl A. Phillipps, Esq.

DOCKET ENTRIES

1942

April 1. Petition received and filed. Taxpayer notified. Fee paid.

April 2. Copy of petition served on General Counsel.

April 29. Answer filed by General Counsel.

April 29. Request for hearing in New York City filed by General Counsel.

May 2. Notice issued placing proceeding on New York City calendar. Service of answer and request made.

1943

January 8. Hearing set February 8, 1943 at New York City.

February 8. Hearing had before Judge Tyson on merits. Submitted. Stipulation of facts filed. Briefs due under Rules.

February 24. Transcript of hearing of February 8, 1943 filed.

March 25. Brief filed by General Counsel.

March 26. Brief filed by taxpayer. 3/26/43 copy served.

April 9. Reply brief filed by taxpayer. 4/9/43 copy served.

1944

April 7. Findings of fact and opinion rendered, Tyson J. Decision will be entered under Rule 50. Copies served on both parties.

May 9. Computation of deficiency filed by General Counsel.

May 11. Hearing set 5/24/44 on settlement.

1944

May 15. Consent to settlement filed by taxpayer.

May 17. Agreed computation filed.

May 19. Decision entered, Tyson J. Div. 1.

August 16. Petition for review by U. S. Circuit Court of Appeals, 2nd Circuit, with assignments of error filed by General Counsel.

August 21. Proof of service filed (Beulah B. Crane) by General Counsel.

August 21. Proof of service filed (Edward S. Bentley) by General Counsel.

September 30. Motion for extension of time to December 14, 1944 to complete and transmit record filed by General Counsel.

September 30. Order granting extension of time to December 14, 1944 to complete and transmit record entered.

November 29. Motion for extension of time to February 12, 1944 to complete and transmit record filed by General Counsel.

November 29. Order granting extension of time to February 12, 1944 to complete and transmit record entered.

1945

January 27. Motion for extension of time to April 13, 1945 to complete and transmit record filed by General Counsel.

January 27. Order granting extension of time to April 13, 1945 to complete and transmit record entered.

March 19. Praecipe for record filed by General Counsel with statement of service by mail thereon.

April 3. Counter designation of record filed by taxpayer with statement of service by mail thereon.

[fols. 1-2] [File endorsement omitted.]

BEFORE UNITED STATES BOARD OF TAX APPEALS

Docket No. 110361

BEULAH B. CRANE, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent.

PETITION—Filed April 1, 1942

The petitioner above-named, Beulah B. Crane, hereby petitions for a redetermination of the alleged deficiency as set forth by the Commissioner of Internal Revenue in his deficiency letter dated January 5, 1942, reference symbols: Brooklyn, New York, RM90D, and as a basis for this proceeding, alleges as follows:

I

That at all the times hereinafter mentioned, and at the present time, Beulah B. Crane, petitioner herein, resided and now resides at 35-64 80th Street, Jackson Heights, in the County of Queens, City and State of New York.

II

That on or prior to March 15, 1939, the petitioner filed with the Collector of Internal Revenue for the First District [fol. 3] of New York a return in the form provided by statute and regulations for the income tax due to the United States of America from the petitioner for the calendar year ending December 31, 1938.

III

That the notice of deficiency, a copy of which is attached hereto and marked Exhibit A, was mailed to the petitioner on January 5, 1942.

IV

That the tax in controversy is an alleged additional income tax for the calendar year ending December 31, 1938, the amount of the deficiency claimed being $1,938.99.

V

That in determining the alleged deficiency set forth in the Deficiency Letter, Exhibit A annexed to the petition, the Commissioner of Internal Revenue erred in the following respects:

(1) In holding that the capital asset which the petitioner received from the estate of her deceased husband, William M. Crane, and which she sold on November 29, 1938, consisted of separate parts, viz., the apartment house building at No. 395 Clinton Avenue, Brooklyn, New York, and the land upon which such building stood.

(2) In refusing to hold that the capital asset which the petitioner received from her husband's estate and sold on [fol. 4] that date consisted of her equity in the said premises.

(3) In reducing the cost of the premises to the petitioner for the purpose of computing capital gain, by deducting depreciation in excess of the value of her equity in the premises, so that the base for computing capital gain was an amount greatly less than the amount of the taxes and the principal and interest of the mortgage then a prior lien on said premises.

(4) In deducting from the cost of the petitioner's equity in the said premises depreciation exceeding 100 per cent of the value thereof and exceeding 100 per cent of the total amount realized by the petitioner on the sale.

(5) In determining an alleged capital gain exceeding the entire gross contract price and selling price received by the petitioner.

(6) In decreasing the cost of the capital assets sold, by alleged depreciation in excess of that used by the petitioner and by the Estate of William M. Crane, deceased, to reduce their respective income tax liability.

(7) In determining that the selling price of the land was $54,471.15.

(8) In determining that the selling price of the building was $203,028.85.

(9) In determining that the cost to the petitioner of the land was $55,000.

[fol. 5] 10. In determining that the cost to the petitioner of the building was $207,042.50.

(11) In determining that the base for computing capital gain of the building should be diminished by depreciation in the sum of $28,045.10.

(12) In holding that the base for computing capital gain of the building was $178,997.40.

(13) In determining that there was a capital gain upon the alleged sale of the building of $24,031.45.

(14) In determining that there was a capital loss upon the alleged sale of the land of $528.85.

(15) In holding that, whereas the land was a capital asset upon which loss was recognized to the extent of 50 per cent thereof, the building was not a capital asset and that the alleged gain on the alleged sale thereof should be recognized to the extent of 100 per cent thereof.

(16) In determining a capital gain in excess of the sum of $2500.00.

VI

That the facts upon which the petitioner relies are as follows:

(1) That your petitioner's husband, William M. Crane, died on January 11, 1932, a resident of Mamaroneck, County of Westchester, and State of New York.

(2) That at the time of his death the said William M. Crane was the owner of a certain apartment house situated [fol. 6] in the Borough of Brooklyn, County of Kings, City and State of New York, known as No. 395 Clinton Avenue, which said premises were subject to a consolidated mortgage held by the Bowery Savings Bank, upon which there was then due the sum of $255,000. of principal and $7,042.50 of interest accrued to the date of death, or a total of $262,042.50.

(3) That one of the constituent mortgages was made by Rell Realty Corp. to Realty Associates, Inc., dated February 7, 1923 and thereafter assigned by Realty Associates, Inc. to Bowery Savings Bank; that the other constituent mortgage was made by Rell Realty Corp. to Bowery Savings Bank dated February 8, 1924; that the

said mortgages were duly consolidated on February 8, 1924 by consolidation agreement dated that day between Rell Realty Corp. and Bowery Savings Bank.

(4) That the said William M. Crane left a last will and testament which was duly admitted to probate by the Surrogate's Court of Westchester County, New York, on January 31, 1932, and that on said date letters testamentary were duly issued by said Surrogate's Court to your petitioner.

(5) That in and by said last will and testament, the said William M. Crane, after directing the payment of his just debts and funeral expenses, gave, devised and bequeathed all the rest, residue and remainder of his property, both real and personal, to your petitioner.

(6) That thereafter in proceedings duly taken in accordance with statute, the Commissioner of Internal Revenue [fol. 7] determined that the value of said real estate at the time of the decedent's death was the sum of $262,042.50 and that the amount due on the aforesaid mortgage to which the said premises were subject was $262,042.50.

(7) That your petitioner was not liable upon the bond of the aforesaid mortgage nor liable for the payment of principal or interest thereon, or taxes upon the mortgaged premises.

(8) That by reason of certain claims filed by alleged creditors against the estate of the said William M. Crane, the estate was not and could not be settled and distributed until on or about December 31, 1936.

(9) That your petitioner as executrix of the Estate of William M. Crane, deceased, duly filed income tax returns for the period from January 11, 1932, to December 31, 1936, wherein were reported the receipts and expenses of the said premises No. 395 Clinton Avenue and wherein depreciation was claimed upon said premises, net income was shown and tax computed as follows:

Year	Depreciation Claimed	Net Income	Tax
1932 (part)	$3,500.00	None	None
1933	3,500.00	None	None
1934	3,800.00	None	None
1935	3,800.00	None	None
1936	3,900.00	None	None

[fol. 8] (10) That except for the years 1932 and 1933, the deduction of the said depreciation did not affect the tax liability of the estate, and that after eliminating the said depreciation the amount of the net income of the estate and the amount of the tax thereon for said years would have been as follows:

Year	Net Income Eliminating Depreciation	Tax
1932	$3,438.61	$92.26
1933	1,569.76	22.79
1934	None	None
1935	None	None
1936	None	None

(11) That your petitioner duly filed income tax returns for calendar year 1937 and for the calendar year 1938, wherein depreciation upon the said premises up to November 29, 1938 was claimed, net income was shown and tax was computed as follows:

Year	Depreciation Claimed	Net Income	Tax
1937	$3,500.00	None	None
1938	3,200.00	None	None

(12) That eliminating the depreciation so deducted in respect to the said premises, the amount of the petitioner's net income and the amount of the petitioner's tax for said periods would have been as follows:

Year	Net Income Eliminating Depreciation	Tax
1937	$1,294.41	$6.60
1938	1,035.85	None

[fol. 9] (13) That the amount of the aforesaid depreciation claimed by the petitioner individually and as executrix as aforesaid, which was used to reduce tax liability aggregated $3,306.89 as follows:

1932	$2,242.51
1933	869.97
1937	194.41
	$3,306.89

(14) That during 1938 the aforesaid first mortgage was in default for nonpayment of principal, interest and taxes,

and that in October 1938, under instructions from the Bowery Savings Bank their attorneys prepared summons and complaint and other papers for the foreclosure thereof; that petitioner offered to execute and deliver to the Bowery Savings Bank a deed in lieu of foreclosure, but the Savings Bank had refused to accept the same.

(15) That thereupon, for the purpose of avoiding a loss of the property by the threatened foreclosure, the petitioner entered into a contract with Avenue C. Realty Corp. for the sale of her equity therein for the sum of $3,000.

(16) That the said contract proyided as follows:

> "The purchase price is Three thousand Dollars ($3,000.) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes or meter charges hereinabove referred to; and the purchaser has deposited the sum of One thousand Dollars ($1,000.) in escrow to be paid to the seller at the time of closing title under this contract, and if title be [fol. 10] not closed for any of the reasons hereinafter set forth, to be repaid to the purchaser."

(17) That on or about November 29, 1938, pursuant to said contract of sale, title was closed. The expenses of the said sale amount to the sum of $500, and the petitioner received the sum of $3000. out of which she paid expenses of the sale amounting to $500, the net amount received being $2500.

(18) The petitioner did not receive any satisfaction of the said morgage held by the Bowery Savings Bank nor any release thereof, nor did the petitioner receive anything else of value in connection with the said sale other than the said sum of $2,500.

(19) That nevertheless, the Commissioner of Internal Revenue determined that the petitioner had received a capital gain of $24,031.45, and determined a deficiency based thereon of $1,932.99.

Wherefore, the petitioner prays that this Board may hear the proceeding and reverse the determination of the Com-

missioner of Internal Revenue contained in his Deficiency letter of January 5, 1942.

Beulah B. Crane, Petitioner; William R. Conklin, Edward S. Bentley, Robert W. Owens, Jr., Sperry Butler, Attorneys for Petitioner.

[fol. 11] *Duly sworn to by Beulah B. Crane. Jurat omitted in printing.*

[fol. 12] EXHIBIT "A" TO PETITION

First New York

TREASURY DEPARTMENT

Internal Revenue Service

Office of
Internal Revenue Agent in Charge
Brooklyn Division
1 Hanson Place
Brooklyn, New York

Jan. 5—1942

Mrs. Beulah B. Crane, % Conklin & Bentley, 20 Exchange Place, New York, New York.

DEAR MADAM:

You are advised that the determination of your income tax liability for the taxable year (s) ended December 31, 1938 discloses a deficiency of $1,932.99 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Brooklyn, New York, for the attention of RM:90D. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period termi-

nates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully, Guy T. Helvering, Commissioner, by
(Signed) Daniel A. Bolich, Internal Revenue Agent in Charge

Enclosures:
Statement.
Form of waiver.
EE:NS

[fol. 13] STATEMENT

Mrs. Beulah B. Crane
% Conklin & Bentley
20 Exchange Place
New York, New York

Tax Liability for the Taxable Year ended December 31, 1938

	Liability	Assessed	Deficiency
Income tax	$1,932.99	None	$1,932.99

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated November 14, 1940; to your protest dated March 13, 1941; to the statements made at the conference held on April 4, 1941, and August 20, 1941.

A copy of this letter and statement has been mailed to your representative, Mr. Robert W. Owens, Jr., 20 Exchange Place, New York, New York, in accordance with the authority contained in the power of attorney executed by you.

Adjustments to Net Income

Net loss as disclosed by return		($2,164.15)
Unallowable deductions and additional Income:		
(a) Ordinary gain from sale of building		$24,031.45
Total		$21,867.30
Nontaxable income and additional deductions:		
(b) Capital gain	$1,250.00	
(c) Capital loss	264.42	1,514.42
Net income adjusted		$20,352.88

Explanation of Adjustments

(a), (b) and (c)—In lieu of a profit of $1,250.00 reported in your income tax return for 1938 as a capital gain on the sale of premises 395 Clinton Avenue, Brooklyn, New York, there has been determined a profit of $24,031.45 on the sale of the building and a capital loss of $264.42 on the sale of the land as set forth herein.

[fol. 14]		Land	Building
Selling Price:		$54,471.15	$203,028.85
Cost of basis:			
Land		55,000.00	
Building	$207,042.50		
Less: Depreciation at 2% on $207,042.50 1932-37 24,845.10 1938 (claimed and allowed, 3,200.00	28,045.10		178,997.40
Gain or loss allowable		(528.85)	$ 24,031.45
50% of loss allowable		(264.42)	
100% of gain on sale of a building which is not a capital asset			$ 24,031.45

[fol. 15] Computation of Tax

Net income adjusted	$20,352.88
Less: Personal exemption	1,000.00
Balance (surtax net income)	$19,352.88
Less: Earned income credit (10% of $3,000.00)	300.00
Net income subject to normal tax	$19,052.88
Normal tax at 4% on $19,052.88	$ 762.12
Surtax on $19,352.88	1,175.87
Total tax	$ 1,937.99
Less: Income tax paid at source	5.00
Correct income tax liability	$ 1,932.99
Income tax assessed: Original account #699987	None
Deficiency of income tax	$ 1,932.99

[fol.16] Before United States Board of Tax Appeals

[Title omitted]

Answer—Filed April 29, 1942

The Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I. Admits the allegations contained in paragraph I of the petition.

II. Admits that the petitioner filed with the Collector of Internal Revenue for the First District of New York a Federal income tax return for the calendar year ended December 31, 1938. Denies the remaining allegations contained in paragraph II of the petition.

III. Admits the allegations contained in paragraph III of the petition.

IV. Admits the allegations contained in paragraph IV of the petition.

V(1) to (16), inclusive. Denies that the respondent, in determining the defieiency in tax, committed errors as alleged in subparagraphs (1) to (16), inclusive, of paragraph V of the petition.

VI (1). Admits the allegations contained in subparagraph (1) of paragraph VI of the petition.

(2). Admits that at the time of his death the petitioner's husband, William N. Crane, was the owner of an apartment [fol. 17] house situated in the Borough of Brooklyn, County of Kings, City and State of New York, known as 395 Clinton Avenue. Denies the remaining allegations contained in subparagraph (2) of paragraph VI of the petition.

(3). Denies the allegations contained in subparagraph (3) of paragraph VI of the petition.

(4). Admits the allegations contained in subparagraph (4) of paragraph VI of the petition.

(5). Denies the allegations contained in subparagraph (5) of paragraph VI of the petition.

(6). Admits the allegations contained in subparagraph (6) of paragraph VI of the petition.

(7) to (10), inclusive. Denies the allegations contained in subparagraphs (7) to (10), inclusive, of paragraph VI of the petition.

(11). Admits that the petitioner filed an income tax return for the calendar year 1938; that depreciation upon the premises of 395 Clinton Avenue, Brooklyn, was claimed in the amount of $3,200.00; and that no net income and no tax liability were shown on the return as filed. Denies the remaining allegations contained in subparagraph (11) of paragraph VI of the petition.

(12) to (16), inclusive. Denies the allegations contained in subparagraphs (12) to (16), inclusive, of paragraph VI of the petition.

(17). Admits that the petitioner received in 1938 the sum of $3,000.00 pursuant to the sale of the 395 Clinton Avenue

property. Denies the remaining allegations contained in subparagraph (17) of paragraph VI of the petition.

[fol. 18] (18). Denies the allegations contained in subparagraph (18) of paragraph VI of the petition.

(19). Admits the allegations contained in subparagraph (19) of paragraph VI of the petition, except it is denied that the Commissioner determined a capital gain.

VII. Denies each and every allegation contained in the petition not hereinbefore specifically admitted or denied.

Wherefore, it is prayed that the determination of the Commissioner be approved.

(Signed) J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue.

Of Counsel:
E. C. Algire,
Division Counsel,
F. S. Gettle,
Special Attorney,
Bureau of Internal Revenue.
FSG:JLN 4-29-42

[fol. 19] IN THE TAX COURT OF THE UNITED STATES

(File endorsement omitted)

Docket No. 110361

BEULAH B. CRANE, Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE, Respondent

STIPULATION OF FACTS—Filed February 8, 1943

It Is Hereby Stipulated and Agreed by and between the parties hereto, by their respective attorneys of record, that the following facts shall be taken as true, without prejudice to the right of either party to introduce further evidence not inconsistent with the facts herein stipulated.

(1) That the petitioner is an individual residing at 35-64 80th Street, Jackson Heights, in the County of Queens, City and State of New York.

(2) That petitioner's individual income tax return for the calendar year 1938 was filed with the Collector of Internal Revenue for the First District of New York.

(3) That petitioner's husband, William M. Crane, died on January 11, 1932, a resident of Mamaroneck, County of Westchester and State of New York, leaving a last Will [fol. 20] and Testament under which the petitioner was the sole legatee and devisee, and which last Will and Testament was duly admitted to probate by the Surrogate's Court of Westchester County on January 31, 1932, and letters testamentary issued to petitioner as executrix. A copy of said last Will and Testament is hereto annexed and marked Exhibit A.

(4) That at the time of his death the said William M. Crane was the owner of a certain apartment house situated in the Borough of Brooklyn, County of Kings, City and State of New York, known as 395 Clinton Avenue, which said premises was subject to a consolidated mortgage held by Bowery Savings Bank upon which there was then due the sum of $255,000 principal and $7,042.50 accrued interest, or a total of $262,042.50.

(5) That the value of the said premises as of the date of the death of the said William M. Crane was appraised for the purpose of the federal estate tax at $262,042.50, and that the amount due on the aforesaid mortgage, to which the said premises was subject, was appraised in said proceedings at $262,042.50, said values being the amounts reported by the petitioner as executrix of the said estate in Schedules A and J of the federal estate tax return.

(6) That for the purpose of this proceeding the said sum of $262,042.50 may be considered as having been allocated as follows:

Land	$55,000.00
Improvements	207,042.50

[fol. 21] (7) That the petitioner was not a party to the foregoing consolidated mortgage or the bond which it secured.

(8) That the estate of the said decedent was not settled and distributed until December 31, 1936.

(9) That the petitioner as executrix of the Estate of William M. Crane, deceased, filed federal income tax re-

turns for the period from January 11th to December 31st, 1932, and for the calendar years 1933 and 1934, copies of which will be handed up to the Court upon the trial of the within proceeding.

(10) That the petitioner as executrix of the said estate also filed federal income tax returns for the calendar years 1935 and 1936, and the petitioner individually filed income tax returns for the calendar years 1937 and 1938 which will be handed up to the Court upon the trial of the within proceeding.

(11) That at all times between February 1, 1932 and November 29, 1938, the said mortgage was in default for non-payment of interest, and that petitioner entered into an arrangement with the Bowery Savings Bank whereby the net income from the premises should be paid to the Bowery Savings Bank on account of the mortgage as evidenced by letters dated February 1st, February 4th, February 8th, March 21st, March 25th, March 28th, and May 27th, 1932, and November 7th and November 8th, 1934, copies of which are hereto annexed and marked Exhibits B, C, D, E, F, G, H, I and J.

[fol. 22] (12) That pursuant to such arrangement the petitioner paid over to the Bowery Savings Bank the net income received from the premises for each calendar year from 1932 to 1938, inclusive.

(13) That for the purpose of the arrangement between the petitioner and the Bowery Savings Bank, the net income was computed without allowance for depreciation.

(14) That in the year 1938 the mortgage on the premises held by Bowery Savings Bank was in default for non-payment of principal, interest and taxes in amounts approximately as follows:

Principal	$255,000.00
Interest	15,857.71

(15) That in order to avoid foreclosure of the mortgage, petitioner entered into a contract with Avenue C Realty Corporation, a copy of which is annexed hereto and marked Exhibit K.

(16) That on November 29, 1938, title was closed pursuant to said contract and the petitioner delivered to the

purchaser therein named, or its assigns, a deed to the premises, a copy of which is annexed hereto and made a part hereof and marked Exhibit L, and the purchaser paid the petitioner the sum of $3,000.00 in cash.

(17) That petitioner paid expenses of sale amounting to $500.00.

[fol. 23] (18) That the rate of depreciation applicable to the apartment house involved in this proceeding was two per cent per annum.

(19) That for the purpose of this proceeding the sales price of the aforesaid premises may be considered as having been allocated in the proportion set forth in the deficiency letter, namely, 5447115/25750000ths for the land and 20302885/25750000ths for the improvements.

Dated, New York, N. Y., February 8, 1943.

Edward S. Bentley, Attorney for Petitioner. (Signed)
J. P. Wenchel, RPH, Attorney for Respondent.

[fol. 24] EXHIBIT "A"

I, William M. Crane, residing at Mamaroneck, Westchester County and State of New York, being of sound and disposing mind and memory, do hereby make, publish and declare this my Last Will and Testament, as follows:

First: I order and direct that all my just debts and funeral expenses shall be paid as soon as they conveniently may be paid after my decease.

Second: All the rest, residue and remainder of my property, both real and personal, and wheresoever the same may be situated, I give, devise and bequeath to my wife, Beulah Bieber Crane.

In the event that my wife is not living at the time of my death, then and in that event I give, devise and bequeath all the rest, residue and remainder of my property, both real and personal and wheresoever the same may be situated, to my sons, Richard Jasper Crane and Howard Bieber Crane, share and share alike.

Third: I hereby nominate and appoint my wife, Beulah Bieber Crane, executrix of this my Last Will and Testa-

ment. In the event of the death, resignation or inability of my wife to act as executrix of this my Last Will and Testament, then I nominate and appoint my son, Richard Jasper Crane, and as soon as my son, Howard Bieber Crane, becomes twenty-one years of age, I nominate and appoint my [fol. 25] said son, Howard Biener Crane, as co-executor with my son, Richard Jasper Crane.

I do order and direct that my said executor shall not be required to give bonds conditioned for the faithful performance of her, his or their duties in any jurisdiction in which it may be necessary or proper to probate this my Last Will and Testament, and I do give and grant unto my said executor full power and authority to sell any or all of my real or personal property at public or private sale on such terms and conditions and at such times as to her, him or them may seem proper, and to give good deeds and conveyances of any such property so sold by her, him or them.

Fourth: I hereby revoke any and all other Wills and Codicils by me heretofore made.

In Witness Whereof, I have hereunto set my hand and affixed my seal this 15th day of February, 1931.

Wm. M. Crane. (Seal.)

Witnesses: Dorothy A. Bentley, Edward S. Bentley.

[fol. 26] On this 15th day of February, 1931, the above named testator, William M. Crane, in our presence subscribed, published and sealed the foregoing instrument, and declared the same to be his Last Will and Testament, and thereupon we, at his request and in his presence, and in the presence of each other have hereunto subscribed our names as attesting witnesses.

Dorothy A. Bentley residing at Lawrence, L. I., N. Y.

Edward S. Bentley residing at Lawrence, L. I., N. Y.

[fol. 27] EXHIBIT "B"

February 1, 1932.

The Bowery Savings Bank,
110 East 42nd Street,
New York City.

Atten.: Mr. F. Smith

DEAR MR. SMITH:

Following out the conversation which you had on Friday with my attorney Mr. William R. Conklin in regard to the premises 395 Clinton Avenue, Brooklyn, on which the Bank holds a mortgage of $255,000. I beg to give you the following information in regard to the income and net, explaining, however, that for the month of February I had to use February 1930, as we cannot find the February statement for 1931, and that beginning with May 1931 Mr. Crane operated this building himself through his superintendent Alfred A. Wright, who now collects the rents. Mr. Wright is bonded.

The receipts by months are as follows:

January	$3,517.50
February	4,155.00
March	3,495.00
April	3,457.50
May	3,170.00
June	3,360.00
July	3,285.00
August	3,355.00
September	3,070.00
October	2,750.00
November	3,569.68
December	3,035.00
Total	$40,219.68

Mr. Crane received net checks after payment of operating expenses, but not payment of taxes, as follows:

[fol. 28]

January	$1,633.62
February	2,804.72
March	2,113.24
April	1,700.84
May	2,794.00
June	2,567.69
July	2,175.60
August	2,292.00
September	1,706.47
October	1,266.74
November	3,233.43
December	1,977.49
Total	$26,265.84
The May taxes were $2,447.80	
The Nov. " " 2,513.75	4,961.55
Net	$21,304.29

These taxes were paid out of the monies received by Mr. Crane and when deducted as an additional item of expense, leave a net of $21,304.29.

Mr. Crane died on January 11th, and I am the sole executrix and sole beneficiary under his will which has been probated in the Surrogate's Court in Westchester County.

I am not in a position now to pay the interest due to-day or the installment of principal, and I would request that in accordance with the conversation which you had with Mr. Conklin, that you allow me to operate the apartment with Mr. Wright as superintendent, pay out the necessary operating expenses, and then turn over to you each month a check for the net amount, and you pay the taxes, or, if you prefer, reserve about $200 each month so that with this reserve and the rents in the months of May and November there will be sufficient for Mr. Wright to pay the taxes.

[fol. 29] As soon as you have had an opportunity to go over these figures or such additional information as you request, as for instance, if you wish to see the monthly statements for the year 1931, they can be submitted to you, let

Mr. Conklin know the form of agreement which you wish to make with me, and on his advice I will execute it.

Allow me at this time to thank you for your co-operation in the matter of protecting the property which is of vital importance to me.

Yours very truly, —— ——.

EJK

[fol. 30] EXHIBIT "C"

February 4, 1932.

The Bowery Savings Bank,
110 East 42nd Street,
New York City.

Atten.: W. F. Sheerin

DEAR MR. SHEERIN:

Following out our conversation of this morning in regard to the handling of rents on the property of the late William M. Crane, No. 395 Clinton Avenue, Brooklyn, I enclose you herewith the statement of Mr. A. A. Wright, the superintendent, for the month of December 1931, which shows the money received and the disbursements. You will notice in connection with Apartment 1-D the rent is marked "collateral."

That tenant gave a note, but he is now paying his rent regularly beginning with January.

We will have Mr. Wright deposit the monies received from rents with the Wallabout Branch of the National City Bank, make the expenditures as he has been heretofore for repairs and wages, reserve $200 a month toward the taxes, and send you a statement like this each month with the check for the balance on hand.

If you have any suggestions to make in regard to the method of handling these funds and reporting, kindly let me know, and we will put them into effect.

Thanking you for your co-operation, I am,

Yours very truly, —— ——.

WRC:EJK

P.S. Kindly return the statement when you have finished with it.

[fol. 31] EXHIBIT "D"

The Bowery Savings Bank

Chartered 1834

110 East 42nd Street

New York

Bond and Mortgage Department. February 8, 1932.

No. 6108

Mr. William R. Conklin
Conklin & Bentley
20 Exchange Place
New York City

DEAR SIR:

We have your letter of February 4th, in reference to property 395 Clinton Avenue, Brooklyn. It is our understanding that you will have the monies received from rents deposited with the Wallabout Branch of the National City Bank, make the expenditures for repairs and wages, reserve $200. a month toward the taxes, and send us a statement each month with the check for the balance on hand.

We are enclosing herewith the statement which you sent us.

Very truly yours, Wm. E. Shurin.

WCS.M.

[fol. 32] EXHIBIT "E"

March 21, 1932.

The Bowery Savings Bank,
110 East 42nd Street,
New York City.

Atten.: Mr. F. Smith

DEAR MR. SMITH:

In connection with the property of Mrs. Crane at 395 Clinton Avenue, Brooklyn, on which we have made the arrangement of turning over to you each month the net income

and made the first payment this month covering the February collections, I have to report the following:

The taxes last year were $4,876.60, which was based on an exemption of $80,000 under the tax reduction allowed for buildings put up in postwar times. This year that exemption is off, and in spite of a reduction obtained through Buckley & Horton, the tax will be $7,743, one half of which, or $3,871.50 will be due in May. Mrs. Crane reserved $200 out of the March check, so that we will need $3,671.50. Estimating that the net for each month is $2,000, there will be needed almost all of the April and May checks to cover these taxes.

Is it your wish that Mrs. Crane should retain simply the $200 from the April check, or should she retain sufficient of it to assure the payment of the taxes in May?

Thanking you for your prompt reply so that we may advise Mrs. Crane, I am,

Yours very truly, —— ——.

WRC:EJK

[fol. 33] EXHIBIT "F"

The Bowery Savings Bank
Chartered 1834
110 East 42nd Street
New York

Bond and Mortgage Department March 25, 1932.

Conklin & Bentley
20 Exchange Place
New York City

Att.: Mr. Wm. C. Conklin

DEAR SIR:

In connection with the property on which we hold the first mortgage, and in answer to your letter of March 21st, we would request that the entire income be turned over to us and that we will make provision out of this income for the payment of taxes and interest.

We believe that we shall apply about half of the April, May and June rentals to taxes, and the other half to interest.

We shall open an account for the accumulation of the tax money and as soon as we have sufficient to pay a bill, we shall send you a receipted bill.

Very truly yours, (Sgd.) H. Held.

HH:B

[fol. 34] EXHIBIT "G"

March 28, 1932

The Bowery Savings Bank, 110 East 42nd Street, New York City.

Atten.: Mr. F. Smith

DEAR MR. SMITH:

In accordance with the arrangement between Mrs. Beulah B. Crane and yourselves in regard to the management of 395 Clinton Avenue we enclose herewith statement of Mr. Alfred A. Wright, superintendent, for March 1932, showing a total amount received of $3,220 and also indicating disbursements, leaving a net amount of $2,313.90. From this Mrs. Crane has deducted the $200 reserve toward taxes, and I enclose herewith her check to your order for $2,113.90.

Mrs. Crane now has on hand toward taxes a reserve of $400.

Yours very truly, ——.

WRC:EJK
Encs.

[fol. 35] EXHIBIT "H"

May 27, 1932

The Bowery Savings Bank, 110 East 42nd Street, New York City.

Atten.: Mr. Smith

DEAR MR. SMITH:

I enclose you herewith statement of Mr. A. A. Wright, superintendent of the Crane Estate property at 395 Clinton Avenue showing net for the month of May of $2,397.44, together with Mrs. Crane's check to your order for $2,-

997.44, being the amount of the May net plus the $200 reserved for February, March, and April toward taxes.

We understand that you will pay the taxes this month on the property out of the monies which have been forwarded to you.

Thanking you for your continued co-operation,

Yours very truly, —— ——.

WRC:EJK
Encs.

[fol. 36] SCHEDULE "I"

THE BOWERY SAVINGS BANK
Chartered 1834
110 East 42nd Street
New York

Frederick C. Smith,
Mortgage Officer

November 7th, 1934

Loan No. 6108 K

Conklin & Bentley, 20 Exchange Place, New York City.

Attention of: Mr. William R. Conklin

DEAR SIRS:

We have considered a request that the interest rate on mortgage, held by us, covering premises 389-97 Clinton Avenue, Brooklyn, be reduced.

If, and provided the owner is willing to pay the sum of $2500 now against the existing arrears on this mortgage, we are willing to reduce the interest rate to 4% retroactively from August 1st, 1933.

It is understood that the rent agreement, which is at present in force is to continue as per its terms, and until all arrears are paid.

This arrangement is to continue for so long as we allow the mortgage to stand unless terminated by notice to you.

Very truly yours, (Sgd.) Fred C. Smith, Mortgage Officer.

FCS:O

[fol. 37] SCHEDULE "J"

November 8, 1934

Bowery Savings Bank, 110 East 42nd Street, New York City.

Attention: Mr. Frederick C. Smith, Mortgage Officer

Re.: Loan Number 6108

DEAR MR. SMITH:

On behalf of our client Mrs. William M. Crane, individually and as executrix of the Estate of William M. Crane, deceased, we accept the proposition contained in your letter of November 7th, 1934 and enclose you herewith three savings bank checks to your order totalling $2,500. These checks we have been holding for two months, pending the decision in this matter.

I would appreciate it if you would send me now a statement showing the arrears of taxes and interest, after giving credit for this $2,500, and the reducing of the interest to 4% retroactively to August 1, 1933.

The present agreement in regard to management of the property and turning over to you the entire net rent will continue until the arrears are paid.

It is our understanding that it is the intention of all parties that this interest arrangement will continue for three years from August 1, 1934.

Yours very truly, —— ——.

WRC:EJK
Enclosures-3

[fol. 38] EXHIBIT "K"

CONTRACT OF SALE

NOTICE

Stoops, areas, cellar steps, trim and cornices of many buildings encroach upon the street, and the City of New York claims the right if it so desires, to remove same. If such encroachments are of a substantial character, title may be unmarketable until the same are removed. The

question as to the substantial character of such encroachments and as to the probable removal of same by the City is largely a matter of opinion. Each purchaser must decide these questions of fact for himself. Your attention is called to the fact that this contract provides that title is to be conveyed subject to such encroachments, if any. The Board of Estimate and Apportionment on April 8, 1926, adopted a general resolution providing for Roadway and Sidewalk Widths, which may require the removal or change of vaults in front of buildings.

The observance of the following suggestions will save time and trouble at the closing of this Title.

THE SELLER

First: Should bring with him all insurance policies and duplicates.

Second: He should also bring the latest tax and water receipts, and any leases, deeds and agreements relating to the premises.

Third: When there is a water meter on the premises it should be read not more than thirty days prior to closing date.

Fourth: If there are mortgages on the premises to be conveyed, the seller should produce receipts showing to what date the interest has been paid, and if the principal has been reduced, evidence of such reduction, in form to be recorded, must be produced and recorded.

Fifth: If the grantor was married prior to September 1, 1930, his wife must join in the execution of the deed conveying real property acquired prior to said date.

Sixth: The seller should furnish to the purchaser a full list of tenants, giving the names, rent paid by each, and date to which rent has been paid.

THE PURCHASER

Should be prepared with money or a certified check drawn to his own order. The certified check may be for an approximate amount and money may be provided for the balance of the settlement.

If this contract is assigned, instructions for drawing the deed and other instruments should be given to the Seller as early as possible.

Title Guarantee and Trust Company

Founded 1883

176 Broadway, Manhattan, 6 East 45th Street, Manhattan, 370 East 149th Street, Bronx, 56 Bay Street, St. George, S. I., 2 William Street, White Plains, N. Y., 175 Remsen Street, Brooklyn, 160-08 Jamaica Avenue, Jamaica, Bridge Plaza North, L. I. City, Mineola, Long Island, Riverhead, Long Island.

Title Insurance

George McAneny, Chairman of the Board; Harold W. Hoyt, President; Clarence F. Lamont, Vice-President; Raye P. Woodin, Vice-President; Purcell C. Robertson, Vice-President and Secretary; Howard Burdick, Vice-President; John E. Egan, Vice-President; William H. Deatly, VicePresident; Loren H. Rockwell, Treasurer; Thomas J. Kappock, Assistant Vice-President; John M. Penchoen, Assistant Vice-President; Charles M. Gambee, Assistant Vice-President; Robert A. Burdick, Assistant Vice-President; Franklin C. Healy, Assistant Vice-President; John F. Kelsey, Assistant VicePresident; Herman G. Maser, Assistant Vice-President; Charles A. Balthazar, Assistant Treasurer; Rolfe Floyd, Jr., Assistant Treasurer; Harry D. Eckler, Assistant Secretary; Purcell B. Robertson, Assistant Secretary; William C. Kammerer, Assistant Secretary; George J. Watson, Assistant Secretary; Edmund C. Donovan, Assistant Secretary; Sedgwick A. Clark, Solicitor.

[fols. 39-40] Agreement, made and dated October, 1938, between Beulah B. Crane, residing at 395 Clinton Avenue, Brooklyn, New York, hereinafter described as the seller, and Avenue C Realty Corp., a New York corporation, having its principal office at 233 Broadway, New York City, hereinafter described as the purchaser.

Witnesseth, that the seller agrees to sell and convey, and the purchaser agrees to purchase all that lot or parcel of land, with the buildings and improvements thereon, in the Borough of Brooklyn, County of Kings, City and State of New York, bounded and described as follows:

Beginning at a point on the Easterly side of Clinton Avenue, distant forty seven (47') feet, six (6") inches Southerly from the Southeasterly corner of Clinton and Greene Avenues; running thence Easterly, parallel with Greene

Avenue, ninety (90') feet; thence Southerly, parallel with Clinton Avenue, three (3') feet; thence Easterly, again parallel with Greene Avenue, thirty (30') feet; thence again Southerly, again parallel with Clinton Avenue, thirty-seven (37') feet; thence Westerly, parallel with Greene Avenue, fifteen (15') feet; thence again Southerly, and again parallel with Clinton Avenue, sixty (60') feet; thence again Westerly, parallel with Greene Avenue, one hundred and five (105') feet to the Easterly side of Clinton Avenue; and thence Northerly, along the Easterly side of Clinton Avenue, one hundred (100') feet to the point or place of beginning.

Together with all the right, title and interest of the party of the first part of, in and to the courtyards lying in front of the above described premises.

Subject to a first mortgage now a lien on said premises, held by Bowery Savings Bank, upon which there is due the principal sum of Two Hundred Fifty Five Thousand Dollars ($255,000.) and arrears of interest in the sum of Fifteen Thousand Eight Hundred Fifty-seven 71/100 Dollars ($15,857.71) and interest to accrue after this date.

Subject to real estate taxes for the second half of the year 1938 and to water meter charges.

The purchase price is Three Thousand Dollars ($3,000.) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes or meter charges hereinabove referred to; and the purchaser has deposited the sum of One Thousand Dollars ($1,000.) in escrow to be paid to the seller at the time of closing title under this contract and if title be not closed for any of the reasons hereinafter set forth, to be repaid to the purchaser.

In any of the following events, the purchaser may rescind this contract and if the contract be so rescinded, the deposit of $1,000. shall be repaid to the purchaser, but the seller shall have no other or further liability for damages or expenses: (a) If the seller can not convey good title subject to the mortgage and taxes above referred to; (b) If the purchaser is unable to make satisfactory arrangements with the Bowery Savings Bank for the extension of the mortgage above referred to.

Provided, however, that if the purchaser elects to take title despite either of the foregoing events said deposit shall be paid to the seller and shall not be paid to the purchaser.

[fol. 41] Except as otherwise herein expressly provided, the "customs in respect to title closings" adopted by the Real Estate Board of New York, shall apply to the apportionments and other matters therein mentioned.

Said premises are sold subject to:

1. Building restrictions and regulations in resolution or ordinance adopted by the Board of Estimate and Apportionment of the City of New York, July 25th, 1916, and amendments and additions thereto now in force.

2. Encroachments of stoops, areas, cellar steps, trim and cornices, if any, upon street or highway.

3. Consents, if any, by seller or any former owner of premises for the erection of any structure or structures on, under or above any street or streets on which said premises may abut.

All personal property appurtenant to or used in the operation of said premises is represented to be owned by the seller and is included in this sale, including coal.

This sale covers all right, title and interest of the seller of, in and to any land lying in the bed of any street, road or avenue opened or proposed, in front of or adjoining said premises, to the center line thereof, and all right, title, and interest of seller in and to any award made or to be made in lieu thereof, and in any unpaid award for damage to said premises by reason of change of grade of any street; and the seller will execute and deliver to the purchaser, on closing of title, or thereafter, on demand, all proper instruments for the conveyance of such title and the assignment and collection of any such award.

The following are to be apportioned:

In the event title is closed under this contract, the seller shall pay over to the purchaser the net rents from October 1, 1938, to date of closing, after deduction of all proper expenses including operating, maintenance and payroll expenses, payroll taxes and insurance charges actually paid, repairs and other expenses customarily paid in the operation of apartment buildings, including installments on conditional contracts of sale, if any.

3. Insurance premiums on existing policies, except compensation insurance, shall be assigned by the seller to the purchaser and included in this sale.

All notes or notices of violation of law or municipal ordinances, orders or requirements noted in or issued by the Tenement House, Fire, Building, Labor, Health, or other State or Municipal Department having jurisdiction, against or affecting the premises at the date hereof, shall be complied with by the seller and the premises shall be conveyed free of the same, and this provision of this contract shall survive delivery of the deed hereunder. The seller shall furnish the purchaser with an authorization to make the necessary searches therefor.

The deed shall be in proper statutory short form for record, substantially in statutory Form C, and shall be duly executed and acknowledged by the seller, at the seller's expense, so as to convey to the purchaser, the fee simple of the said premises, free of all encumbrances except as herein stated. Said deed shall also contain a covenant by the grantor as follows:

The grantor, in compliance with Section 13 of the Lien Law, covenants that the grantor will receive the consideration for this conveyance as a trust fund to be applied first for the purpose of paying the cost of the improvement and that the grantor will apply the same first to the payment of the cost of the improvement before using any part of the total of the same for any other purpose.

The risk of loss or damage to said premises by fire until the delivery of the deed is assumed by the seller.

The deed shall be delivered, with the necessary revenue stamps thereto attached, upon the receipt of said payments at the office of Conklin & Bentley, Attorneys for seller, 20 Exchange Place, New York City, at two o'clock on December 8th, 1938.

Alexander Sinai of 1775 Broadway, is recognized as the broker effecting this sale but the purchaser agrees to pay the broker's commission therefor and the purchaser and the broker agree to hold the seller harmless and indemnify her from any claim of broker's commission.

The stipulations aforesaid are to apply to and bind the heirs, executors, administrators, successors and assigns of the respective parties.

Witness the signatures and seals of the above parties.

In the presence of: Beulah B. Crane, Seller; Avenue C Realty Corp., By —— ——, President, Purchaser; Alexander Sinai, Broker.

[fol. 42] [Endorsed:] No. —. Beulah B. Crane and Avenue C Realty Corp. Contract. Premises: 395 Clinton Avenue, Brooklyn, New York. We have been actively engaged in examining titles to real estate for over half a century. Our charges are moderate. Apply to any of our offices. Title Guarantee and Trust Company Offices: 176 Broadway, New York; 175 Remsen Street, Brooklyn; 160-08 Jamaica Ave., Jamaica; 6 East 45th Street, New York; 370 East 149th Street, Bronx; Bridge Plaza North, L. I. City; 56 Bay Street, St. George, S. I.; Mineola, Long Island; Riverhead, Long Island; White Plains, New York.

[fol. 43] EXHIBIT "L"

This Indenture, made the 28th day of November, one thousand nine hundred and thirty-eight, between Beulah B. Crane, residing at 395 Clinton Avenue, Brooklyn, New York, individually and as sole executrix and devisee and legatee under the Last Will and Testament of William M. Crane, deceased, probated in the Surrogate's Court of Westchester County, party of the first part, and Florence Steinman, residing at 1570 Ocean Parkway, Brooklyn, New York, party of the second part:

Witnesseth, that the party of the first part, in consideration of One Hundred ($100.00) dollars, lawful money of the United States, and other good and valuable considerations, paid by the party of the second part, does hereby grant and release unto the party of the second part, her heirs, administrators and assigns forever,

All that lot or parcel of land, with the buildings and improvements thereon, in the Borough of Brooklyn, County of Kings, City and State of New York, bounded and described as follows:

Beginning at a point on the Easterly side of Clinton Avenue, distant forty seven (47′) feet, six (6″) inches Southerly from the Southeasterly corner of Clinton and Greene Avenues; running thence Easterly, parallel with Greene Avenue, ninety (90′) feet; thence Southerly, parallel with Clinton Avenue, three (3′) feet; thence Easterly, again parallel with Greene Avenue, thirty (30′) feet; thence again Southerly, again parallel with Clinton Avenue, thirty-seven (37′) feet; thence Westerly, parallel with Greene Avenue, fifteen (15′) feet; thence again Southerly, and

again parallel with Clinton Avenue, sixty (60') feet; thence again Westerly parallel with Greene Avenue, one hundred and five (105') feet to the Easterly side of Clinton Avenue; and thence Northerly, along the Easterly side of Clinton Avenue, one hundred (100') feet to the point or place of beginning.

Together with all the right, title and interest of the party of the first part of, in and to the courtyards lying in front of the above described premises.

Subject to a first mortgage now a lien on said premises, held by Bowery Savings Bank, upon which there is due the principal sum of Two Hundred Fifty Five Thousand Dollars ($255,000) and arrears of interest.

Subject to real estate taxes for the second half of the year 1938 and to water meter charges, if any.

Together with all the right, title and interest of the party of the first part in and to the land in the bed of Clinton Avenue adjoining the above premises up to the center line thereof.

[fol. 44] together with the appurtenances and all the estate and rights of the part—of the first part in and to said premises.

To have and to hold the premises herein granted unto the part—of the second part, —— and assigns forever.

[fol. 45] And the party of the first part covenants as follows:

First.—That the party of the first part has not done or suffered anything whereby the said premises have been incumbered in any way whatever.

Second.—That, in compliance with Section 13 of the Lien Law, the party of the first part will receive the consideration for this conveyance as a trust fund to be applied first for the purpose of paying the cost of the improvement, and that the party of the first part will apply the same first to the payment of the cost of the improvement before using any part of the total of the same for any other purpose.

In Witness Whereof, the party of the first part has hereunto set her hand and seal the day and year first above written.

In presence of Wm. A. Croh.

Beulah B. Crane. (L. S.)

STATE OF NEW YORK,
County of New York, ss.:

On the 28th day of Nov., one thousand nine hundred and thirty-eight, before me came Beulah B. Crane to me known to be the individual described in, and who executed, the foregoing instrument, and acknowledged that she executed the same.

Raymond C. Cochrane.

Raymond D. Cochrane, Notary Public, Kings Co. Clk. No. 506, Reg. No. 9156. New York County Clks. No. 293, Reg. No. 9C343. Bronx County Clks. No. 3, Reg. No. 122C39. Queens County Clks. No. 1712, Reg. No. 6675. Nassau County Clks. No. 9C22 Certificate filed in Westchester County. Commission expires Mar. 30, 1939.

[fol. 46] [Endorsed:] No. —. to Deed the land affected by the within instrument lies in Block —— in Section —— on the Land Map of the County of Title Guarantee and Trust Company. Offices: 176 Broadway, New York; 175 Remsen Street, Brooklyn; 160-08 Jamaica Ave., Jamaica; 6 East 45th Street, New York; 370 East 149th Street, Bronx; Bridge Plaza North, L. I. City; 56 Bay Street, St. George, S. I.; Mineola, Long Island; Riverhead, Long Island, White Plains, New York.

[fol. 47] IN THE TAX COURT OF THE UNITED STATES

BEULAH B. CRANE, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 110361. Promulgated April 7, 1944

Under the will of her husband petitioner acquired improved real property consisting of an apartment house and the land upon which it was located, which at the date of his death was subject to a mortgage in an amount equal to the fair market value of the property at that date. Petitioner never assumed the mortgage debt. She sold the property

and received $2,500 in cash from the vendee, who took title subject to the mortgage. *Held:*

(1) The amount of the mortgage is not part of the "amount realized" by the petitioner from the sale and the only amount realized by her was $2,500.

(2) The basis of the property in the hands of the petitioner is zero.

(3) Under the provisions of section 113 (b) (1) (B) of the Revenue Act of 1938, the basis of zero can not be reduced on account of depreciation of the building.

(4) The apartment house on the land was not a capital asset, as was the land within the meaning of section 117 (a) of the Revenue Act of 1938, and the portion of the gain allocable to the sale of the building is taxable in full as an ordinary gain, while the portion allocable to the sale of the land is taxable as a capital gain.

Edward S. Bentley, Esq., for the petitioner.
Carl A. Phillipps, Esq., for the respondent.

Respondent determined a deficiency of $1,932.99 in income tax for 1938. The sole question for determination is the amount of the gain realized by the petitioner from the disposition in the taxable year of property previously acquired by her by devise from her deceased husband. The parties have filed a stipulation of facts, which we adopt as part of our findings of fact. The stipulated facts not set forth herein are included by reference.

[fol. 48] FINDINGS OF FACT

The petitioner, a resident of Jackson Heights, New York, is the widow of William M. Crane, who died on January 11, 1932. She filed her 1938 income tax return in the first district of New York.

William M. Crane (hereinafter referred to as the decedent) was a resident of Westchester County, New York, at the time of his death. His will was probated in the Surrogate's Court of that county on January 31, 1932, and under the provisions thereof the petitioner was his sole legatee and devisee. The petitioner was also the duly qualified executrix of the decedent's estate. The estate was settled and distributed on December 31, 1936.

The decedent owned an apartment house and the premises on which it was located in Brooklyn, New York, which, at the time of his death, was subject to a first mortgage held by the Bowery Savings Bank, on which there was due at that time $255,000 principal and $7,042.50 accrued interest, or the total sum of $262,042.50. For the purpose of the Federal estate tax the property was appraised as of January 11, 1932, at a value of $262,042.50 and the amount due on the mortgage was likewise appraised at $262,042.50. In the Federal estate tax return filed by the petitioner as executrix of the estate of the decedent, the property was reported at the value of $262,042.50 and the amount due on the mortgage was reported as an indebtedness of the estate in the same amount.

On February 1, 1932, and at all times thereafter until the property was sold and conveyed on November 29, 1938, as hereinafter stated, the mortgage was in default for the nonpayment of interest. In the early part of 1932 the petitioner and the Bowery Savings Bank entered into an agreement whereby the petitioner was to operate the apartment house property, collect the rents, and pay for all necessary repairs, wages, and other expenses, reserve $200 a month for the payment of taxes, and remit the balance, or net rentals, to the bank at the end of each month on account of the mortgage. The net rentals from the premises for the years 1932 to 1938, inclusive, were paid to the bank by the petitioner in accordance with the agreement and applied to the payment of interest on the mortgage.

In 1938 the mortgage was in default for nonpayment of principal in the amount of $255,000 and interest in the amount of $15,857.71, and the bank was about to foreclose its mortgage. In order to avoid such action the petitioner in October 1938 entered into a contract to sell the property to the Avenue C Realty Corporation. The contract of sale provided, in part, as follows:

* * * the seller [petitioner] agrees to sell and convey, [here follows a description of the real estate] * * *

[fol. 49] Subject to a first mortgage now a lien on said premises, held by Bowery Savings Bank, upon which there is due the principal sum of * * * ($255,000.) and ar-

rears of interest in the sum of * * * ($15,857.71) and interest to accrue after this date.

Subject to real estate taxes for the second half of the year 1938 and to water meter charges.

The purchase price is * * * ($3,000.) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes or meter charges hereinabove referred to; and the purchaser has deposited the sum of * * * ($1,000.) in escrow to be paid to the seller at the time of closing title under this contract * * *

The deed shall * * * convey to the purchaser, the fee simple of the said premises, free of all encumbrances except as herein stated.

Pursuant to the contract, title was closed on November 29, 1938, and on that date the petitioner, individually and as executrix of the decedent's estate and as sole devisee and legatee, conveyed the property to the purchaser, "subject to a first mortgage now a lien on said premises, held by Bowery Savings Bank, upon which there is due the principal sum of * * * ($255,000.) and arrears of interest." The petitioner received $3,000 in cash from the purchaser and paid expenses of the sale in the amount of $500. The petitioner was not a party to the mortgage or to the bond which secured it. She did not at any time assume any personal liability upon the mortgage.

Petitioner filed income tax returns for the estate of the decedent covering the period January 11 to December 31, 1932, and the years 1933, 1934, 1935, and 1936, and individual income tax returns for the years 1937 and 1938. In those returns, in addition to income from other sources, she reported the rentals from the apartment house as gross income and claimed deductions for interest paid on the mortgage, and for the taxes on and operating expenses of the property. She also claimed deductions for depreciation on the building as follows:

1932	$3,500	1936	$3,900
1933	3,800	1937	3,500
1934	3,800	1938	3,200
1935	3,800		

In her income tax return for 1938 the petitioner reported a net loss of $2,164.15. She reported a capital gain

of $2,500 from the sale of the apartment house property and included one-half thereof, or $1,250, in her income.

The respondent determined that the petitioner sustained a capital loss of $528.85 (allowable to the extent of 50 percent) from the sale of the land, and that she realized an ordinary gain of $24,031.45 from the sale of the building. The loss and gain were computed in the following manner:

[fol. 50]

Selling price			$54,471.15	$203,028.85
Cost or basis:				
Land			55,000.00	
Building		$207,042.50		
Less depreciation at 2% on $207,042.50:				
1932-38	$24,845.10			
1938 (claimed and allowed)	3,200.00			
		28,045.10		178,997.40
		Loss	528.85	Gain 24,031.45
50% of loss allowable			264.42	
100 of gain on sale of a building which is not a capital asset				24,031.45

The "selling price" set out in the tabulation just above is comprised of the $2,500 net cash received by petitioner on the sale and the $255,000 principal due on the mortgage.

The parties have stipulated that the appraised value of the property as of the date of the decedent's death, namely, $262,042.50, may be considered as having been allocated as follows: land, $55,000; improvements, $207,042.50; that the "selling price" of the property may be considered as having been allocated in the proportion determined by the respondent, namely 5447115/25750000 to the land and 20302885/25750000 to the improvements; and that the rate of depreciation applicable to the building is 2 percent per annum.

Opinion

Tyson, Judge:

The question for determination is the amount of the petitioner's gain or loss from the sale of the property which she had acquired by devise. The applicable statutory pro-

visions found in the Revenue Act of 1938 are set forth in the margin.[1]

[fol. 51] The respondent found the amount realized by petitioner on the sale to be $257,500 and the basis to be $262,042.50. The amount realized is composed of the $255,000 principal due on the mortgage at the time of the sale and the $2,500 net cash received from the purchaser, as conceded by respondent at the hearing and on brief; and the basis is the value at which the property was appraised for the purpose of the Federal estate tax, which value was in an amount identical with the amount of $255,000 principal due on the mortgage at decedent's death plus $7,042.50 accrued interest thereon. The respondent allocated the basis and the amount realized between the land and the building, as shown in our findings of fact, and then reduced the portion of the basis allocated to the build-

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[1] SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) Computation of Gain or Loss—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) Amount Realized—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) Basis (Unadjusted) of Property.—The basis of property shall be the cost of such property; except that—

* * * * * * *

(5) Property Transmitted at Death.—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

(b) Adjusted Basis.—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

ing ($207,042.50) by $28,045.10 on account of depreciation on the building for the years 1932 to 1938. This resulted in an adjusted basis of $178,997.40 for the building. On the basis of his findings, he determined an ordinary gain of $24,031.45 from the sale of the building and a capital loss of $528.85 from the sale of the land.

The petitioner's first contention is that the inclusion of the amount of the mortgage in the amount realized for the property is improper, on the ground that she acquired that property encumbered by the mortgage debt, which she never assumed and for which she was never personally liable; and that consequently she did not receive, and could not have received, any benefit or consideration, as regards the mortgage, by reason of her transfer of the property subject to the mortgage. Petitioner's second contention is that, having acquired the property with a mortgage encumbrance thereon equal to its fair market value, she acquired a mere equity in the property the value of which was zero, and that when she sold the property she realized a taxable gain of only $2,500 (the $3,000 cash received less $500 as expenses of the sale).

The respondent's position is that his action in including the amount of the mortgage in the amount realized from the sale, in fixing the basis at $262,042.50, and in reducing

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(1) General Rule.—Proper adjustment in respect of the property shall in all cases be made—

* * * * * * *

(B) in respect of any period since Febrary 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws.

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) Basis for Depreciation.—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * * * *

that basis by the amount of $28,045.10 for depreciation, was not in error, and that petitioner's gain is not to be determined on the theory that she acquired and sold a mere equity in the property.

[fol. 52] The first question presented by the respective contentions of the parties is whether the amount of the mortgage constitutes part of the "amount realized" by petitioner from the sale. Section 111(b), *supra*, provides that the "amount realized" from the sale of property shall be "the sum of any money received plus the fair market value of the property (other than money) received." The facts show and the respondent concedes, that petitioner received money to the extent of only $2,500 from the sale. If the petitioner had assumed liability for the payment of the mortgage debt and her vendee had in turn assumed petitioner's liability, such assumption by the vendee would be the equivalent of the receipt of "money" by the petitioner to the extent of the amount of the liability so assumed. *Brons Hotels, Inc.*, 34 B. T. A. 376; *Walter F. Haass*, 37 B. T. A. 948. Cf. *United States* v. *Hendler*, 303 U. S. 564; *Pender* v. *Commissioner*, 110 Fed. (2d) 477. However, the petitioner acquired the property by devise and did not assume liability for payment of the mortgage debt. She took title "subject to" the mortgage and never was under a personal obligation to pay it, or any part of it. *Helvering* v. *Southwest Consolidated Corporation*, 315 U. S. 194. As she was never under any personal obligation to pay the mortgage debt she received no consideration whatever when she sold and conveyed the property subject to the mortgage, except the $2,500 in money mentioned above. *Commonwealth, Inc.*, 36 B. T. A. 850; *James B. Lapsley*, 44 B. T. A. 1105; and *Polin* v. *Commissioner*, 114 Fed. (2d) 174. Except for the $2,500, the petitioner thus did not receive money, or the equivalent of money, or property (other than money) having a fair market value, and it was error for the respondent to include the amount of the mortgage in the "amount realized" from the sale.

In support of his contention that the amount of the mortgage should be included in the amount realized from the sale of the property, respondent relies upon article 44-2 of Regulations 101, which provides that in the case of a sale on the installment basis of mortgaged real property, "the amount of the mortgage, whether the property is merely taken subject to the mortgage or whether the

mortgage is assumed by the purchaser, shall be included as a part of the 'selling price,' " It suffices to say that this regulation applies only to sales, on the installment plan, of real property involving deferred payments to the vendor and relates to the returning of profits from such sales. It is obvious that the sale by petitioner was not such a sale and that the regulation has no application here.

The amount realized by the petitioner from the sale, therefore, was $3,000 less the $500 paid for conveyancing, or $2,500.

The next question presented is the proper basis of the property for the determination of petitioner's gain or [fol. 53] loss on her sale. The first and essential factor to be determined in this connection is the unadjusted basis of the property. This unadjusted basis is that established by section 113(a)(5), *supra*, to wit, the fair market value of the property at the time of its acquisition. Time of acquisition here means the date of the husband's death. *Brewster v. Gage*, 280 U. S. 327; *Elizabeth G. Augustus*, 40 B. T. A. 1201; affd., 118 Fed. (2d) 38; certiorari denied, 313 U. S. 585.

There is no dispute here as to the fair market value of the apartment house property at the basic date. That value is $262,042.50, which was used for estate tax purposes. However, the property when acquired by the petitioner was encumbered by a mortgage in an amount which, together with the accrued interest thereon, was equal to the fair market value of the property. It is thus apparent that the interest of petitioner in the apartment house property had no fair market value whatever when acquired by her. It further appears that petitioner paid nothing on the mortgage during her ownership of the property, except the interest which she paid out of the rentals received by her from the property, and this would preclude any claim of a cost basis on account of an investment in the property by the petitioner, even if such claim were made. *Fulton Gold Corporation*, 31 B. T. A. 519; cf. *P. J. Hiatt*, 35 B. T. A. 292; and *Hotel Astoria, Inc.*, 42 B. T. A. 759. It follows that petitioner's unadjusted basis is zero.

The issue then narrows down to the question of whether petitioner's unadjusted basis of zero should be adjusted

on account of the depreciation allowed in prior years and in the taxable year.

In the ordinary case, that is where there is a basis for property, the adjustment on account of depreciation operates to reduce that basis, which, as so reduced, is to be offset against the amount realized in determining the gain or loss; and section 113(b)(1)(B), *supra*, in providing that the adjusted basis for determining gain or loss "shall be the basis *determined* under [section 113(a)(5)] adjusted" for depreciation, obviously contemplates the existence of an unadjusted basis—that there exists a minuend from which depreciation allowed, or allowable can be deducted. See *Woolford Realty Co. v. Rose*, 286 U. S. 319, 327. We have *determined* that the unadjusted basis of the property in question, under section 113(a)(5), is zero, and, this being true, there is, in the very nature of things, nothing to adjust—nothing from which depreciation can be deducted.

Having found that petitioner's unadjusted basis is zero and that such basis can not be adjusted to a minus quantity, we conclude and so hold that the proper basis to be used in computing petitioner's gain is zero, and, as the amount realized by her from the sale of the property was only $2,500, that her gain from the sale is in the same [fol. 54] amount. In view of this holding it is unnecessary to decide or consider the question of whether or not depreciation on the property for prior years was properly allowed or allowable in those years; but since depreciation in the amount of $3,200 was allowed for the taxable year 1938, and that year is before us, we hold that such depreciation was improperly allowed for the reason that there is no basis upon which to compute depreciation—the unadjusted basis being zero.

In her income tax return for 1938 the petitioner reported a gain of $2,500 from the sale of the property and included one-half thereof in her income as a capital gain. In her petition she alleges error by the respondent in ruling that the building was not a capital asset and in treating the gain as an ordinary gain taxable in full. The petitioner does not argue this question and contends in her brief only that her gain was not in excess of $2,500. The respondent contends that the building is not a capital asset within the meaning of section 117 of the Revenue Act of

1938,[2] and that the profit realized from the sale of the building is an ordinary gain taxable in full. We think the respondent's contention is sound.

Section 117, in subdivision (a), defines the term "capital assets" and states that the term "does not include • • • property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1)." The allowance provided in section 23(1) is "a reasonable allowance for exhaustion, wear and tear." The apartment house building is property which loses value through exhaustion, wear, and tear, and hence is property of a character which is subject to the allowance provided in section 23(1). *Even Realty Co.*, 1 B. T. A. 355, 359, 362. The petitioner, upon default in the mortgage, was permitted to remain in possession and operate the property under an arrangement whereby the net rents or profits were applied on payment of taxes and payment of interest on the mortgage. This, in our opinion, was use of the property in the petitioner's trade or business. The building thus meets the tests of depreciable character and business use, and it is a noncapital asset and not subject to the capital gain and loss provisions of section 117, *supra*.

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[2] SEC. 117. CAPITAL GAINS AND LOSSES.

(a) Definitions.—As used in this title—

(1) Capital Assets.—The term "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include • • • property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 23(1);

• • • • • • •

(b) Percentages Taken Into Account.—In the case of a taxpayer, other than a corporation, only the following percentages of the gain or loss recognized upon the sale or exchange of a capital asset shall be taken into account in computing net income:

• • • • • • •

50 per centum if the capital asset has been held for more than 24 months.

[fol. 55] The parties have stipulated that, for the purpose of this proceeding, the "selling price" or the amount realized from the sale of the property "may be considered as having been allocated" between the land and building in the proportions set forth in our findings of fact. Inasmuch as $2,500 was the total "selling price," or amount realized, and such amount also constituted the sole gain derived from the sale, such gain should be allocated as follows: 5447115/25750000 to the land and 20302885/25750000 to the building. The amount allocated to the land constitutes capital gain, taxable at capital gain rates, and the amount allocated to the building constitutes ordinary gain, taxable in full.

Reviewed by the Court.

Decision will be entered under Rule 50.

SMITH and DISNEY, JJ., dissent.

[fol. 56] IN THE TAX COURT OF THE UNITED STATES, WASHINGTON

Docket No. 110361

BEULAH B. CRANE, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

DECISION

Pursuant to the Court's Findings of Fact and Opinion, promulgated April 7, 1944, the respondent having filed a recomputation of tax on May 9, 1944, and the petitioner having filed an acquiescence in said recomputation on May 15, 1944, it is

Ordered and Decided: That there is a deficiency in income tax of $27.77 for the calendar year 1938.

Entered:

(Signed) John A. Tyson, Judge.

Entered May 19, 1944.

[fol. 57] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[File endorsement omitted]

[Title omitted]

PETITION FOR REVIEW AND ASSIGNMENTS OF ERROR—Filed August 16, 1944

To the Honorable Judges of the United States Circuit Court of Appeals for the Second Circuit:

Now Comes Joseph D. Nunan, Jr., Commissioner of Internal Revenue, by his attorneys, Samuel O. Clark, Jr., Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Charles E. Lowery, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I

Jurisdiction

That he is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States; that the respondent on review, Beulah B. Crane (hereinafter called the taxpayer), is a citizen of the United States residing at 35-64 80th Street, Jackson Heights, in the County of Queens, City and State of New York. The taxpayer filed her Federal income tax returns for the calendar year 1938, the taxable year here involved, with the Collector of Internal Revenue for the First District of New [fol. 58] York whose office is located in the City of Brooklyn, New York, and within the jurisdiction of the United States Circuit Court of Appeals for the Second Circuit.

The Commissioner files this petition pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code.

II

Prior Proceedings

On January 5, 1942, the Commissioner determined a deficiency in Federal income tax liability against the taxpayer in the amount of $1,932.99 for the taxable year 1938

and sent to the taxpayer, by registered mail, a notice of said deficiency in accordance with the provisions of existing internal revenue laws. Thereafter and on April 1, 1942, the taxpayer filed an appeal from the Commissioner's determination with The Tax Court of the United States. The case was duly tried and submitted to the Tax Court and on April 7, 1944, the court promulgated its findings of fact and opinion pursuant to which opinion decision was entered on May 19, 1944 "that there is a deficiency in income tax of $27.77 for the calendar year 1938."

III

Notice of Controversy

The taxpayer is the widow of William M. Crane who died on January 11, 1932. She was the sole legatee and devisee under the will of her deceased husband and the executrix of his estate which was settled and distributed on December 31, 1936. At the time of his death the decedent owned an apartment house and the premises on which it was located [fol. 59] in Brooklyn, New York, which property was on that date subject to a first mortgage on which there was due a principal of $255,000 and accrued interest in the amount of $7,042.50. In the Federal estate tax return filed by the taxpayer as executrix the property was reported at the value of $262,042.50, the amount of the unpaid mortgage and interest, and the amount so due on the mortgage was reported as an indebtedness of the estate. The property was appraised, for purposes of the Federal estate tax, at the value of $262,042.50 as of January 11, 1932 and the amount due on the mortgage was likewise appraised at $262,042.50.

The mortgage was in default for the nonpayment of interest at all times after January 31, 1932 (the date on which decedent's will was probated in the Surrogate's Court of Westchester County, New York) until the property was sold and conveyed by the taxpayer on November 29, 1938 as hereinafter stated.

Early in the year 1932 the taxpayer entered into an arrangement with the Bowery Savings Bank, the holder of the first mortgage on the property in question, whereby she was to operate the apartment house property, collect the rents, and pay for necessary repairs, wages, and other

expenses, reserve $200 a month for the payment of taxes, and turn the balance over to the bank at the end of each month on account of the mortgage. Accordingly the net rentals from the property for the years 1932 to 1938, inclusive, were paid to the bank by the taxpayer and applied to the payment of interest on the mortgage. In 1938, in order to avoid a threatened foreclosure action by the bank, the taxpayer entered into a contract to sell the property to the Avenue C Realty Corporation, subject to the first mortgage, which was due in the amount of $255,000 and upon which interest was in arrears in the sum of [fol. 60] $15,857.71, and subject to real estate taxes for the second half of the year 1938 and to water meter charges. In the contract of sale the purchase price was designated as "* * * ($3,000) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes or meter charges hereinabove referred to; * * *." The property was conveyed to the purchaser, or its assignee, on November 29, 1938 by the taxpayer "individually and as sole executrix and devisee and legatee under the Last Will and Testament of William M. Crane, deceased, probated in the Surrogate's Court of Westchester County" subject to the first mortgage lien thereon and arrears of interest. The taxpayer received the $3,000 in cash specified in the contract of sale and paid expenses of the sale amounting to $500.

The rentals received from the apartment house were returned as gross income in the Federal income tax returns filed for decedent's estate for the period January 11 to December 31, 1932 and the years 1933, 1934, 1935 and 1936, and in the individual Federal income tax returns of the taxpayer for the years 1937 and 1938. Deductions were claimed in those returns for interest paid on the mortgage, for the taxes on and operating expenses of the property, and for depreciation on the building. In her individual Federal income tax return for the year 1938, the taxpayer reported a capital gain of $2,500 from the sale of the apartment house property, one-half of which, or $1,250, she returned as taxable income. In his examination of the taxpayer's Federal income tax liability for that year the Commissioner determined a capital loss of $528.85 from the sale of the land and an ordinary gain of $24,031.45 from the sale of the building, both determinations having been based on allocations, as between the land and the building,

of the appraised value of the property as of the date of [fol. 61] decedent's death and the "selling price" of the property by the taxpayer in 1938, as to the correctness of which allocations the parties have agreed for the purpose of this proceeding. In his determination the Commissioner likewise reduced the basis allocated to the building ($207,042.50) by $28,045.10 representing depreciation on the building for the years 1932 to 1938, inclusive.

The taxpayer disputed the inclusion by the Commissioner of the amount of the mortgage as having been realized by the taxpayer for the property when it was transferred by her, on the ground that since she had not assumed the mortgage she was never personally liable thereon. She contended that she had acquired a mere equity in the property the value of which was zero and that when she sold the property her taxable gain was measured by the difference between the $3,000 cash received by her in the transaction and the expense of $500 incurred by her on the sale.

In deciding the issue for the taxpayer and contrary to the holding of the Commissioner, the Tax Court held that the amount of the unsatisfied mortgage was not part of the "amount realized" by the taxpayer from the sale, that her basis was zero, and that the only amount realized by her was $2,500 ($3,000 for her equity less $500 expenses). The court sustained the Commissioner's determination that the apartment house was not a capital asset within the meaning of Section 117(a) of the Revenue Act of 1938, and that the portion of the gain allocable to the sale of the building is taxable in full as an ordinary gain. The court held further that depreciation in the amount of $3,200 was improperly allowed for the taxable year 1938 "for the reason that there is no basis upon which to compute depreciation—the unadjusted basis being zero."

[fol. 62] Based on its holding, as aforementioned, the Tax Court redetermined a deficiency in income tax against the taxpayer in the amount of $27.77 for the taxable year 1938.

IV

Assignments of Error

The Commissioner avers that in the record and proceedings before The Tax Court of the United States and in the opinion and final decision rendered and entered by The

Tax Court of the United States, manifest error occurred and intervened to the prejudice of the Commissioner who now assigns the following errors and each of them, which he avers occurred in said record, proceedings, opinion and final decision so rendered and entered by The Tax Court of the United States:

1. The Tax Court erred in failing and refusing to sustain the deficiency in tax determined by the Commissioner.

2. The Tax Court erred in entering its decision wherein and whereby it was ordered and decided that there is a deficiency in income tax of only $27.77 for the calendar year 1938.

3. The Tax Court erred in holding and deciding that the amount of the mortgage was not part of the "amount realized" by the taxpayer from the sale and that the only amount realized by her was $2,500.

4. The Tax Court erred in holding and deciding that the basis of the property in the hands of the taxpayer was zero.

5. The Tax Court erred in failing and refusing to hold and decide that, as determined by the Commissioner, the amount realized by the taxpayer upon the sale of the apartment house property was $257,500, that the basis to [fol. 63] the taxpayer of said property was $262,042.50, of which amount $207,042.50 was allocable to the apartment building, that the adjusted basis of the said building to the taxpayer at the date of sale was $178,997.40 ($207,042.50 minus $28,045.10 depreciation), and that, accordingly, the taxpayer realized a taxable ordinary gain of $24,031.50 from the sale of the building and a capital loss of $528.85 from the sale of the land.

6. The Tax Court erred in that its holding and decision are not supported by by' are contrary to its findings of fact and the facts as stipulated by the parties.

7. The Tax Court erred in that its opinion and decision are not supported by its findings of fact and are contrary to law.

Wherefore, the Commissioner petitions that the decision of The Tax Court of the United States be reviewed by the United States Circuit Court of Appeals for the Second Cir-

cuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the erors complained of may be reviewed and corrected by said Court.

Samuel O. Clark ——, Assistant Attorney General; J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, Attorneys for Petitioner on Review.

Of Counsel: Charles E. Lowery, Special Attorney, Bureau of Internal Revenue.

[fol. 64] *Duly sworn to by Charles E. Lowery. Jurat omitted in printing.*

[fol. 65] [File endorsement omitted.]

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed Aug. 21, 1944

To Mrs. Beulah B. Crane, 35-64 80th Street, Jackson Heights, County of Queens, New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 16th day of August, 1944, file with the Clerk of the Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

Dated this 16th day of August, 1944.

(Signed) J. P. Wenchel, CAR, Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 18 day of August, 1944.

Beulah B. Crane, Respondent on Review.

[fols. 66-88] [File endorsement omitted.]

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

[Title omitted]

NOTICE OF FILING PETITION FOR REVIEW—Filed Aug. 21, 1944

To Edward S. Bentley, Esq., 20 Exchange Place, New York, New York.

You are hereby notified that the Commissioner of Internal Revenue did, on the 16th day of August, 1944, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Second Circuit of the decision of the Tax Court heretofore rendered in the above-entitled cause. A copy of the petition for review and assignments of error as filed is hereto attached and served upon you.

Dated this 16th day of August, 1944.

(Signed) J. P. Wenchel, CAR, Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 17th day of August, 1944.

(S.) Edward S. Bentley, Attorney for Respondent on Review.

[fol. 89] In United States Circuit Court of Appeals
For the Second Circuit, October Term, 1945

No. 23

(Argued November 14, 1945. Decided December 28, 1945.)

Docket No. 19825

Commissioner of Internal Revenue, Petitioner,

vs.

Beulah B. Crane, Respondent

Before: L. Hand, Swan and Frank, Circuit Judges

On petition of the Commissioner of Internal Revenue to review an order of the Tax Court, expunging a deficiency, assessed against the respondent in her income tax for the year 1938.

Morton K. Rothschild, for the petitioner.

Edward S. Bentley, for the respondent.

Opinion

[fol. 90] L. Hand, Circuit Judge:

The Commissioner appeals from an order of the Tax Court, expunging a deficiency assessed against the taxpayer in her income tax for the year 1938. The question is of the amount of the gain realized upon a sale in that year of a parcel of real property. The facts were as follows. The taxpayer was the widow of one, Crane, who died on January 11, 1932, and who by his will devised to her an apartment house in Brooklyn, on which at the time there was a mortgage of $262,042.50, and which was appraised at his death at exactly that amount. The taxpayer allowed the mortgage to remain in default (accounting to the mortgagee for rentals), until the accumulated interest had risen to $15,857.71, and the mortgagee threatened to foreclose. To avoid this on November 29, 1938, she sold the property for $3000 to a realty corporation, subject to the mortgage and to past due taxes; but, since the expenses of the sale were $500, she received only $2500 net. In the

years 1932-1936, inclusive, she had filed income tax returns as executrix of the devisor, in each of which she had claimed and had been allowed deductions for depreciation upon the building; and in the years 1937 and 1938 she had claimed and been allowed similar deductions in her individual income tax return. In the year here in question the Commissioner allowed her a loss upon the land, measured by the difference between its value at the time of the devise and its proper proportion of the sum of the principal of the mortgage and $2500. However, he also assessed her for a gain measured by the difference between the building's proper proportion of the same sum and its value at the time of the devise, which however he reduced by the deductions for depreciation. The appeal does not concern the figures; it only raises the question whether the taxpayer [fol. 91] is right—as the Tax Court held, two judges dissenting—in insisting that the only gain for which she was taxable was the $2500, which she received upon the sale.

Although the taxpayer was the devisor's sole legatee, the Commissioner does not suggest that she was liable upon his bond, if indeed he was himself liable. The case is therefore to be decided on the assumption that her only relation to the mortgagee was that as devisee of the land, she took it encumbered by the lien of the mortgage. When we speak of her as the "mortgagor," this must be implied. Section 113(a)(5) defines the "unadjusted basis" of property in the case of a devise as its "fair market value" when it was acquired, which in the case at bar was its appraised value as part of the devisor's estate. To find the "adjusted basis" under §111(a) an "adjustment * * * shall * * * be made * * * for * * * wear and tear * * * to the extent allowed (but not less than the amount allowable)"; §113(b)(1)(B). Section 114(a) makes the "basis" for depreciation as a deduction from income the same as the "adjusted basis" fixed by §113(b); and it follows, if the value of mortgaged property at the time of its devise is the value of the equity, as the taxpayer asserts, that the annual allowance for depreciation must be computed upon that value, and that it will represent only that fraction of the actual "wear and tear" suffered by the buildings which their proportion of the equity bears to their actual value. The gain upon which the mortgagor must pay a tax will indeed be reduced so far as actual "wear and tear" reduces the selling price, and we may assume for

argument that the allowance for depreciation and this reduction will be the same. Yet, so far as the mortgagor has not been allowed for depreciation by progressive installments, the allowance will all come in one year, which is clearly contrary to the intent of the act—§23(1)—and to [fol. 92] the uniform practice of the Treasury. Moreover, to treat the equity as the basis for depreciation requires repeated recomputations, if the mortgagor pays in installments and introduces administrative complication and confusion extremely undesirable, if it is possible to avoid them. We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings.

If so, unless the "adjusted value" of the buildings is not computed upon the same value in finding the subtrahend in the equation of gain, the taxpayer gets a double deduction. By hypothesis he will have been allowed deductions seriatim, based upon the actual value of the buildings; and he will in addition have got a reduction in his gain to the extent to which actual "wear and tear" has reduced the selling price. Manifest justice demands that he must surrender one or the other, and the only question is whether the language of the statute forbids that result. The taxpayer concedes, as we understand it—in any event it is the law—that, if she had been liable upon the bond and the vendee had released her, the release would have been "property (other than money) received" within the meaning of §111(b). *United States* v. *Hendley*, 303 U. S. 564. She insists, however, that because she was not liable, the lien should not be considered as an equivalent. But the lien of a mortgage does not make the mortgagee a co-tenant; the mortgagor is the owner for all purposes; indeed that is why the "gage" is "mort," as distinguished from a "vivum vadium." *Kortright* v. *Cady*, 21 N. Y. 343, 344. He has all the income from the property; he manages it; he may sell it; any increase in its value goes to him; any decrease falls on him, until the value goes below the amount of the lien. The mortgagee is a creditor, and in effect nothing more than a preferred creditor, even though the [fol. 93] mortgagor is not liable for the debt. He is not the less a creditor because he has recourse only to the land, unless we are to deny the term to one who may levy upon only a part of his debtor's assets. When therefore upon a sale the mortgagor makes an allowance to the ven-

dee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared, or as though it were a condition upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received "property (other than money)"; yet the effect is precisely the same of the transaction at bar.

To this the taxpayer answers that the result may be, as it was here, to subject the mortgagor to a tax upon a gain which is out of all proportion to what he in fact receives; to a tax which may indeed be greater than the whole consideration received. That is true, but it is the consequence of his continuing in a venture from which he is free to retire whenever he concludes that all opportunity for gain has ended. He is not charged with gain except upon "a sale or other disposition" of the property—§111(a)—and if he abandons it to the mortgagee there is no gain. *Bingham* v. *Commissioner*, 105 Fed. (2) 971 (C. C. A. 2); *Polin* v. *Commissioner*, 114 Fed. (2) 174 (C. C. A. 3); *Commissioner* v. *Hoffman*, 117 Fed. (2) 987 (C. C. A. 2). Nor has the mortgagor been deprived of this expedient by the decision of the Supreme Court in *Helvering* v. *Hammel*, 311 U. S. 504, which held that a foreclosure sale is a "sale" within §111(b). The Third Circuit has since then twice held that he may still abandon the property, forestalling a foreclosure sale by the tender of a deed to the mortgagee; and we agree. *Stokes* v. *Commissioner*, 124 Fed. (2) 335; *Commissioner* v. *Green*, 126 Fed. (2) 70. (*Semble*, *Stam-*
[fol. 94] *ler* v. *Commissioner*, 145 Fed. (2) 37 (C. C. A. 3). True, a slight sum of money will make the transaction a sale, even when the parties may not have looked on it as such (*Blum* v. *Commissioner*, 133 Fed. (2) 447 (C. C. A. 2); but escape is open to the mortgagor as soon as he decides to treat the venture as at an end. If he does not, especially when as here he seeks to realize a profit upon it, it is plainly right that he should be compelled to take the transaction as a whole, including such past advantages as he may have been entitled to as allowances for depreciation.

Order reversed.

SWAN, Circuit Judge, dissenting:

I think that the order should be affirmed for the reasons stated in the Tax Court's opinion, 3 T. C. 585.

[fol. 95] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

COMMISSIONER OF INTERNAL REVENUE, Petitioner,

v.

BEULAH B. CRANE, Respondent

Appeal from The Tax Court of the United States

JUDGMENT—Filed December 28, 1945

This cause came to to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is reversed.

It is further ordered that a Mandate issue to the said The Tax Court of the United States in accordance with this decree.

Alexander M. Bell, Clerk.

[File endorsement omitted.]

[fol. 96] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 97] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed April 29, 1946

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied

the petition shall be treated as though filed in response to such writ.

Mr. Justice Jackson took no part in the consideration or decision of this application.

[fol. 98] IN THE SUPREME COURT OF THE UNITED STATES

STIPULATION—Filed May 28, 1946

Subject to the approval of this Honorable Court, it is hereby stipulated and agreed by and between the attorneys for the parties in the above-entitled cause that, for the purposes of the writ of certiorari, the printed record shall consist of the following:

1. Docket entries.
2. Petition for a redetermination by Tax Court.
3. Answer.
4. Stipulation of facts and Exhibits A to L inclusive attached thereto.
5. Findings of fact and opinion of Tax Court.
6. Decision of Tax Court.
7. Petition for review.
8. Notice of filing petition for review.
9. Proceedings in the Circuit Court of Appeals.
10. This stipulation.

——— ———, Attorney for Petitioner. J. Howard McGrath, Solicitor General of the United States, Attorney for Respondent.

Dated, this 21st day of May, 1946.

[fol. 99] [File endorsement omitted]

Endorsed on Cover: Enter Edward S. Bentley. File No. 50,697. U. S. Circuit Court of Appeals, Second Circuit. Term No. 68. Beulah B. Crane, Petitioner, vs. Commissioner of Internal Revenue. Petition for a writ of certiorari and exhibit thereto. Filed March 25, 1946. Term No. 68 O. T. 1946.

FILE COPY

No. 94 68

CHARLES E. HOPE CROSLEY

Supreme Court of the United States

BEULAH B. CRANE,

Petitioner,

(Respondent in the Circuit Court of Appeals and Petitioner in the Tax Court),

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent,

(Petitioner in the Circuit Court of Appeals and Respondent in the Tax Court).

PETITION FOR WRIT OF CERTIORARI

and

BRIEF IN SUPPORT THEREOF.

EDWARD S. BENTLEY,
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New York, N. Y.

Gilbert & Field, Inc., 43 Cedar St., New York, N. Y., U. S. A.

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V. Mrs. Crane received no income within the meaning of the 16th Amendment except the sum of $2,500 on which she paid an income tax. The determination of the Second Circuit Court that she received income of $24,031.45, if required by the Revenue Act, violated Article I of the Constitution and the 5th Amendment thereto 26

VI. Upon the grounds stated in the petition, and in this brief, a writ of certiorari should be granted to review the determination of the Circuit Court of Appeals in this case 28

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Supreme Court of the United States

BEULAH B. CRANE,
Petitioner,

(Respondent in the Circuit Court of Appeals and Petitioner in the Tax Court),

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

(Petitioner in the Circuit Court of Appeals and Respondent in the Tax Court).

PETITION FOR WRIT OF CERTIORARI
and
BRIEF IN SUPPORT THEREOF.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petitioner, Beulah B. Crane, for her petition herein, respectfully shows to this Honorable Court as follows:

I.

Pursuant to subdivisions (a) and (b) of Rule XXXVIII of this Honorable Court, your petitioner respectfully applies for a writ of certiorari to review the decision and judgment of the United States Circuit Court of Appeals, Second Circuit, rendered in the above-entitled proceeding on December 28, 1945, reported 153 F. 2d 504, which reversed the determination and order of the Tax Court of the

United States rendered herein on April 7, 1944, reported in 3 T. C. 585.

II.

The Jurisdiction of This Court.

The jurisdiction of this Court is invoked under Sec. 240 (a) of the Judicial Code (8 F. C. A., Tit. 28, §347).

This proceeding involved alleged additional income taxes for the calendar year 1938. The 90-day letter of the Commissioner of Internal Revenue claiming a deficiency of $1,932.99 was mailed on January 5, 1942. The petition to the Tax Court of the United States (then Board of Tax Appeals) was filed on April 1, 1942. The findings of fact and opinion of the Tax Court were promulgated on April 7, 1944. The decision of the Tax Court determining a deficiency of $27.77 was entered on May 19, 1944. On August 16, 1944, the Commissioner filed his assignments of error and petition for review by the Circuit Court of the United States for the Second Circuit. The decision of the Circuit Court of Appeals for the Second Circuit reversing the Tax Court was rendered on December 28, 1945.

III.

Statement of the Matters Involved.

The facts were simple and undisputed.

William M. Crane, a resident of the State of New York, died on January 11, 1932. At the time of his death he owned real estate in Brooklyn, New York, improved by an apart-

ment house. The real estate was subject to a mortgage then in default, made by a former owner of the property, the Rell Realty Company. This mortgage was held by the Bowery Savings Bank of New York, and there was due upon it at the time of his death principal of $255,000 and interest in arrears of $7,042.50, or a total of $262,042.50. The value of the real estate as appraised in federal estate tax proceedings was $262,042.50.

Under the residuary clause of Mr. Crane's will, the property passed to his wife, Beulah B. Crane, the petitioner herein. She did not assume the mortgage and was not liable upon it or obligated to pay it in any way. During all the time she owned it, the apartment house was managed by the Bowery Savings Bank under an assignment of rents. Mrs. Crane received no income or other benefit from the property.

Between 1932 and 1938, the estate in its income tax returns for 1932 and 1933, and Mrs. Crane in her income tax returns for subsequent years showed deductions for depreciation on the building of $25,500. Such deductions were greater than the income from all sources otherwise taxable, and the tax benefit to the estate and to Mrs. Crane was only a nominal amount.

In October, 1938, in order to avoid foreclosure, Mrs. Crane made a contract to sell her equity in the property for $3,000. The contract provided:

> "The purchase price is Three Thousand Dollars ($3,000) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes, or meter charges hereinabove referred to."

On November 29, 1938, Mrs. Crane conveyed the real estate to the purchaser subject to the foregoing mortgage,

upon which, as previously stated, she was not liable. The purchaser did not pay or assume or agree to pay the mortgage. At that time, the amount due on the mortgage was $255,000 of principal and $15,857.71 of interest, or a total of $270,857.71.

Mrs. Crane received $3,000 in cash. She received no release of the mortgage debt. Expenses of sale were $500. "The amount realized by the petitioner from the sale, therefore, was $3,000, less the $500 paid for conveyancing, or $2,500" (3 T. C. 586).

The foregoing facts were found by the Tax Court (with the exception of the amount of her tax benefit, which was shown by the evidence, but as to which the Tax Court made no finding one way or another).

In her income tax return for 1938, Mrs. Crane reported a capital gain of $2,500. The Commissioner of Internal Revenue claimed that the gain was $24,031.45, divided between ordinary gain on the building and capital loss on the land in proportions stipulated by the parties.

The applicable provisions of the Revenue Act are shown in the accompanying brief.

The Tax Court found that Mrs. Crane's gain was $2,500, apportioned between the land and building in the manner stipulated; that her unadjusted basis was zero, which was not capable of reduction for depreciation below zero; that she received only $2,500; that the mortgage of $262,042.50, upon which she was not liable, formed no part of the consideration received or "amount realized" by her.

Judge Tyson wrote the opinion of the Tax Court which was reviewed by the full Court. Judges Smith and Disney dissented without opinion.

This resulted in a deficiency of $27.77 from which no petition or cross-petition for review was filed by Mrs. Crane.

The Circuit Court of Appeals, Second Circuit, reversed the Tax Court and, without discussing the figures, sustained the Commissioner's determination, viz.: that Mrs. Crane's gain was $24,031.45; that her unadjusted basis was $262,042.50; that her adjusted basis was $234,997.40; and that the amount realized was $257,500, which included the cash of $2,500 and the principal amount due on the mortgage.

Circuit Judge Learned Hand wrote the opinion, in which Judge Frank concurred. Circuit Judge Swan dissented upon the opinion of the Tax Court.

IV.

The Questions Presented.

(1) Whether the findings of the Tax Court of the United States as to the amount realized upon the sale, the basis of the property sold, and the amount of the gain upon the sale, were subject to review and reversal by the Circuit Court of Appeals.

(2) Whether the principal amount due on the defaulted mortgage of $255,000, which was a lien upon the property when Mrs. Crane inherited it, and for the payment of which Mrs. Crane was not liable under the law of the State of New York, was part of the "amount realized" by Mrs. Crane from the sale; or, specifically, whether the "amount realized" was $2,500 as held by the Tax Court, or $257,500, as claimed by the Commissioner and as held by the Circuit Court of Appeals.

(3) Whether the "unadjusted basis" of the mortgaged property received by Mrs. Crane under her husband's will was the value of her equity or the value of the real estate free from the mortgage; or, specifically, whether the

"unadjusted basis" was zero as held by the Tax Court, or $262,042.50 as claimed by the Commissioner and as held by the Circuit Court of Appeals.

(4) Whether the "unadjusted basis" of zero can be reduced through the deduction of depreciation so as to create a fictitious "adjusted basis" of a minus quantity; or, specifically, whether the "adjusted basis" for gain or loss was zero, as held by the Tax Court, or minus (—) $28,045.10, as claimed by the Commissioner. Alternatively, as suggested by the Court upon the argument, whether depreciation on the building should be included in the "amount realized" upon the sale in 1938, and, if so, whether the amount to be included was the depreciation "allowed or allowable", or the depreciation which resulted in tax benefit for Mrs. Crane.

(5) Whether the imposition of an "income" tax on a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received $2,500, was authorized by Article I, Section 8 and the 16th Amendment of the Constitution, or violated Article I, Section 9 and the 5th Amendment of the Constitution.

V.

Grounds for Granting the Within Petition.

(1) The said decision and judgment of the United States Circuit Court of Appeals, Second Circuit, is in conflict with the applicable decisions of this Court, viz.: *John Kelly Co.* v. *Commissioner*, U. S. , decided January 7, 1946 and *Dobson* v. *Commissioner*, 320 U. S. 489. The *Kelly* case removed the prevailing misapprehension as to the continued force of the *Dobson* case, but

was decided after the Circuit Court of Appeals had rendered its decision herein, and hence did not come to the Court's attention until too late to be given effect.

(2) The said decision and judgment of the United States Circuit Court of Appeals, Second Circuit, is in conflict with the decision of the United States Circuit Court of Appeals, Fifth Circuit, in *Hilpert* v. *Commissioner*, 151 F. 2d 929, and in conflict with the decisions of the United States Circuit Court of Appeals, Third Circuit, in *Stokes* v. *Commissioner*, 124 F. 2d 335, and *Polin* v. *Commissioner*, 114 F. 2d 174 (see also *Commissioner* v. *Green*, 126 F. 2d 70), wherein it was held that the amount of a mortgage or other encumbrance to which the real estate was subject, formed no part of the "amount realized", where the seller was not personally liable for the payment of the bond, mortgage, or other obligation. It was also inconsistent with the Second Circuit's decision, *Bingham* v. *Commissioner*, 105 F. 2d 971, and decisions of the Court of Appeals of the District of Columbia, *Hale* v. *Helvering*, 85 F. 2d 819, and of the Fifth Circuit, *Turney's Estate* v. *Commissioner*, 126 F. 2d 712, relating to transfers to the mortgagee without cash consideration, which hold that the amount of the mortgage was not part of the "amount realized" at least where there was no substantial personal liability or where no release of personal liability was given.

(3) The United States Court of Appeals, Second Circuit, has decided an important question of local law, viz., the nature and extent of the obligation of the owner of mortgaged real estate, and the effect of a conveyance thereof, subject to such mortgage,—in a manner contrary to the statutes and decisions of the State of New York wherein the mortgaged real estate was situated, which hold that (a) where real estate is sold "subject to" an existing mortgage

which the purchaser does not assume or agree to pay, the real estate is the primary fund for the payment of the mortgage and the purchaser is under no obligation to discharge it (*Belmont* v. *Cowan*, 22 N. Y. 438), (b) in such case the amount of the mortgage debt is not part of the consideration for the purchase (*Smith* v. *Truslow*, 84 N. Y. 660, 662), (c) a conveyance of the mortgaged real estate by an owner who was not liable for the mortgage debt cannot affect the rights of the mortgagee in respect to the mortgaged realty, or as against any persons liable for the mortgage debt (*Marshall* v. *Davies*, 78 N. Y. 414), and (d) in the case of a mortgage such as the one in the case at bar, executed prior to September 1, 1933, the extent of such liability, where it exists, is not the total amount due on the mortgage, but is measured by the difference between the amount due on the mortgage with interest and costs, less the market value as determined by the Court or the foreclosure sale price whichever is higher (New York Civil Practice Act, Sec. 1083-a; *Matter of Burrows*, 283 N. Y. 540, 545).

(4) The United States Circuit Court of Appeals, Second Circuit, has construed the Revenue Act in a manner contrary to the 16th Amendment, and in violation of Article I of the Constitution and the 5th Amendment thereto, in that the said Court has imposed an "income" tax of $1,932.99 upon a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received, directly or indirectly, in money, property, value, or otherwise the sum of $2,500.

(5) The United States Circuit Court of Appeals, Second Circuit, has decided important questions of tax law hereinbefore specifically enumerated in this petition, which have not been but should be settled by this Court.

(6) In each of the foregoing respects, the said decision and judgment of the United States Circuit Court of Appeals, Second Circuit, so far departed from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

VI.

Petitioner begs leave to amplify her arguments and reasons for granting the writ, in the brief which is herewith submitted.

VII.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued under the seal of this Court directed to the United States Circuit Court of Appeals for the Second Circuit, sitting at New York, N. Y. commanding that Court to certify and send to this Court on a day to be designated, a full and complete transcript of the record and of all proceedings had by the Circuit Court of Appeals in said cause, to the end that this cause may be reviewed and determined by this Honorable Court, that the said decision and judgment of the Circuit Court of Appeals be reviewed by this Honorable Court; and that your petitioner be granted such further relief as may seem proper.

And your petitioner will ever pray.

BEULAH B. CRANE,
Petitioner.

UNITED STATES OF AMERICA,
SOUTHERN DISTRICT OF NEW YORK, } ss.:

BEULAH B. CRANE, being duly sworn, deposes and says:

That she is the petitioner herein; that she has read the foregoing petition subscribed by her, and that the facts stated therein are true to the best of her knowledge, information and belief.

BEULAH B. CRANE.

Sworn to before me this
19th day of March, 1946.

ALBERT GRIMECK
Notary Public, Queens County
Certificate filed in New York County
Commission expires March 30, 1947

I hereby certify that I have examined the foregoing petition; that in my opinion it is well founded and entitled to the favorable consideration of the Court, and that it is not filed for the purpose of delay.

Dated, March 19, 1946.

EDWARD S. BENTLEY,
Counsel.

Supreme Court of the United States

BEULAH B. CRANE,
Petitioner,

(Respondent in the Circuit Court of Appeals and Petitioner in the Tax Court),

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent,

(Petitioner in the Circuit Court of Appeals and Respondent in the Tax Court).

BRIEF IN BEHALF OF PETITIONER.

I.

The Applicable Statutes.

The statutory formula for determining gain or loss is simple.

Sec. 111(a) of the Revenue Act of 1938, which governed the tax for the year in question provided:

> "(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis, provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized".

In other words, this subdivision provided that in computing gain or loss only two elements were to be considered, viz.: (1) The amount realized from the sale; and (2) the adjusted basis provided in Sec. 113(b). If the amount realized from the sale was greater than the adjusted basis, there was a gain.

We shall state these elements in order.

(a)

The "amount realized" was defined in Sec. 111(b) thus:

> "(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received".

(b)

Coming now to the "adjusted basis", it was provided in Sec. 113(b) as follows:

> "(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a) adjusted as hereinafter provided".

In other words, it was necessary first to establish the "basis" under Sec. 113(a), and then to "adjust" this basis in accordance with Sec. 113(b).

It was stated in Regulations 103, Sec. 19.113(a)-1:

> "The basis of property for the purpose of determining gain or loss from the sale or other disposition thereof is the unadjusted basis prescribed in Sec. 113(a), adjusted for the various applicable items specified in Sec. 113(b)".

Subdivision (5) of Sec. 113(a) of the 1938 Revenue Act defined the basis to be used in this case. It read:

> "(5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition".

(c)

The method of determining the "adjusted basis" was laid down in sub-division (1) of Sec. 113(b) as follows:

> "(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—
>
> (A) • • •
>
> (B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws".

II.

The reversal of the Tax Court by the Circuit Court of Appeals was a glaring violation of the rule of this Court in *Dobson* v. *United States*, 320 U. S. 489. The findings upon which the decision of the Tax Court was based, were not subject to review by the Circuit Court of Appeals.

The Tax Court made the following findings:

(a) As to the amount realized.

> "The facts show and the respondent (Commissioner) concedes, that petitioner received money to the extent of only $2,500 from the sale.

"As she (Mrs. Crane) was never under any personal obligation to pay the mortgage debt she received no consideration whatever when she sold and conveyed the property subject to the mortgage, except the $2,500 in money mentioned above.

"Except for the $2,500, the petitioner thus did not receive money, or the equivalent of money, or property (other than money) having a fair market value.

"The amount realized by the petitioner from the sale, therefore, was $3,000 less the $500 paid for conveyancing, or $2,500."

(b) As to the unadjusted basis.

"The property when acquired by the petitioner was encumbered by a mortgage in an amount which, together with the accrued interest thereon, was equal to the fair market value of the property.

"The interest of petitioner in the apartment house property had no fair market value whatever when acquired by her."

(c) As to the adjusted basis.

"We have *determined* that the unadjusted basis of the property in question, under section 113(a)(5), is zero, and, this being true, there is, in the very nature of things, nothing to adjust—nothing from which depreciation can be deducted."

(d) The Tax Court's computation.

"We conclude and so hold that the proper basis to be used in computing petitioner's gain is zero, and, as the amount realized by her from the sale of the property was only $2,500, that her gain from the sale is in the same amount."

Having thus found as a fact that the minuend was $2,500 and that the subtrahend was zero, the ascertainment of the

gain of $2,500 and the computation of the tax thereon was a simple arithmetical problem.

From a reading of the statutory formula and definitions quoted in our Point I, several conclusions necessarily follow:

(1) Under no circumstances can the gain exceed the "amount realized" as defined in Sec. 111(b).

(2) Depreciation, where it enters into the formula, reduces the "basis". It cannot be used to increase the "amount realized".

When, therefore, the Tax Court made its finding that the "amount realized" by Mrs. Crane was $2,500, it seems to us self-evident that such finding should have ended the case, and that no counter-finding of fact or conclusion of law by the Circuit Court of Appeals was possible under the law to reverse the Tax Court's judgment.

The Circuit Court of Appeals, however, with Judge Swan dissenting, took a different view.

Premising its remarks with the following observation:

> "The appeal does not concern the figures; it only raises the question whether the taxpayer is right—as the Tax Court held, two Judges dissenting—in insisting that the only gain for which she was taxable was the $2,500 which she received upon the sale",

the Circuit Court of Appeals substituted for the Tax Court's findings, the following findings of its own:

> (*a*) *As to the amount realized.*
>
> "When therefore upon a sale the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared, or as though it were a condition

upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received 'property (other than money)'; yet the effect is precisely the same of the transaction at bar."

In figures, this meant that the amount realized, including the mortgage principal was $257,500.

(*b*) *As to the unadjusted basis.*

"Section 113(a)(5) defines the "unadjusted basis" of property in the case of a devise as its "fair market value" when it was acquired, which in the case at bar was its appraised value as part of the devisor's estate."

This made the unadjusted basis $262,042.50.

(*c*) *As to the adjusted basis.*

"We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings".

The depreciation so computed was $28,045.10, which gave a figure of $178,997.40 as the adjusted basis of the building, and $55,000 for the land.

(d) The computation of the Circuit Court of Appeals.

As stated, the Circuit Court of Appeals did not concern itself with figures. The actual result was a gain of $24,031.45 for the building all of which was recognized and a loss of $528.85 on the land, 50% of which was recognized.

In thus reversing the Tax Court's findings, and substituting findings of its own, and adopting the tax computations of the Commissioner, the Circuit Court of Appeals committed a clear violation of the rule of the *Dobson* case.

Matters relating to gain or loss, and the basis for the purpose of determining gain or loss, including the amount which was realized on the sale and the allowance, if any, for depreciation, are essentially matters for determination by the "Exchequer Court", the Tax Court of the United States.

Dobson v. *United States*, 320 U. S. 489;
McDonald v. *Commissioner*, 323 U. S. 57, 64;
John Kelly Company v. *Commissioner*, ' U. S.

Even if the determination of such elements was not a pure finding of fact, it fell within that class of mixed questions of fact and law which this Court held in the *Kelly* case, were exclusively for determination by the Tax Court and not subject to review by the Circuit Court of Appeals. Indeed, the language which this Court used in the *Kelly* case might well have been spoken in the case at bar.

If the decision of this Court in *Kelly Company* v. *Commissioner*, had preceded the decision of the Circuit Court of Appeals in this case, and had been brought to its attention, it is inconceivable that the Circuit Court of Appeals would have reversed the Tax Court. Any doubts in the minds of the Judges of the Circuit Court of Appeals as to the effect to be given to the *Dobson* case would have been dispelled by the emphatic language of this Court in the *Kelly* case.

Clearly then, this flagrant disregard of the principles repeatedly announced by this Court should not pass unnoticed, and this Court should issue its writ of certiorari to the Circuit Court of Appeals, Second Circuit, in order to set the matter right, and avoid that incentive to further violations of the *Dobson* rule which would otherwise necessarily ensue.

III.

The holding by the Circuit Court of Appeals, Second Circuit, that the amount realized by Mrs. Crane on the sale included not only the cash of $2,500 received on closing, but also the sum of $255,000 unpaid principal of the mortgage for which Mrs. Crane was not liable, was in conflict with the decisions of the Circuit Court of Appeals, Fifth Circuit, and Circuit Court of Appeals, Third Circuit, referred to in the foregoing petition.

When the case at bar was argued and briefed, the opinion of the Circuit Court of Appeals, Fifth Circuit, in *Hilpert* v. *Commissioner*, 151 F. 2d 929, had not been announced and was not available to Court or counsel.

In its essentials, there is little difference between the *Hilpert* case and the case at bar. Mr. and Mrs. Hilpert owned real estate in Florida. In consideration of $65,000 they conveyed it to the lender subject to a repurchase agreement exercisable at their option. The Florida Court held that this was an equitable mortgage under which they had the right to redeem. Pending the decision of the Florida Court, they made a contingent contract to sell the real estate for $17,067.67 cash, and the purchaser agreed to pay the money necessary to redeem. Following the decision of the Florida Court title was closed. It was conceded that the Hilperts were not liable on the mortgage. The question arose whether the redemption price was part of the "amount realized" by the Hilperts on the sale.

The Tax Court announced the same rule which it adopted in the case at bar. It said:

> "There is no dispute as to basis. The controversy relates to the amount of the consideration. It is true

that all that petitioners received upon the sale was the cash paid to them by the vendees. * * *"

"* * * Only when the facts are so peculiar that the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received can it safely be eliminated from the computation of gain."

For reasons not material here, the Tax Court held that the rule did not apply.

The Circuit Court of Appeals, Fifth Circuit, reversed the Tax Court, and held that the amount of the mortgage or redemption price was not part of the amount realized by the Hilperts.

The Circuit Court of Appeals said:

"We find no fault with the foregoing statement of legal principles but only in their application to the peculiar facts in this case. We think that the Tax Court erred in its view as to what the Hilperts received."

It concluded:

"Since there was no note, no covenant, and no agreement to repay the $65,000, and no enforceable obligation against the Hilperts in the transaction, the Tax Court was wrong in holding that the payment of the $54,364.67 by Lawton Investment Company in redeeming the property was a benefit received by the sellers out of that purchase. The case clearly comes within the exception stated by the Tax Court that when the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received it is appropriate that the amount paid by another to redeem property from the mortgage should be eliminated from the computation of gain to the mortgagor.

> "Since there was no personal liability that could accrue against the Hilperts, all that they got out of the transaction was the $17,067.67."

There are also the decisions in the Third Circuit.

> *Stokes* v. *Commissioner*, 124 F. 2d 335;
> *Polin* v. *Commissioner*, 114 F. 2d 174;
> *Commissioner* v. *Green*, 126 F. 2d 70.

In *Stokes* v. *Commissioner, supra,* a dummy or "straw man" was liable on the bond. The Commissioner claimed that an agreement existed to release the "straw man" and that a conveyance of the mortgaged property to the mortgagee operated as a release of the owner, thereby providing consideration for the conveyance sufficient to characterize the transaction as a sale.

Commenting on the Commissioner's argument, the Third Circuit said, at page 338:

> "None of this has the ring of reality to one who knows only a little of Pennsylvania mortgage law and practice (citing cases). And in Pennsylvania it is not to be disputed that a beneficial owner is not liable on the bond of a straw party . . . Furthermore, it does not appear that a release of the straw parties was bargained for when the security was surrendered."

The Court continued:

> "If no such bargain was made, the surrender of security is not converted into a sale or exchange by any assumption, correct or otherwise, that the law implied a release because of the surrender."

In *Polin* v. *Commisisoner*, 114 F. 2d 174, the taxpayer, at the time of the foreclosure of the mortgage, was given a release from liability on the mortgage bond. The Commis-

sioner claimed that thereby he had received property (other than money), equal in value to the amount due on the mortgage, plus interest. It was proven, however, that the taxpayer had received a release some ten years before, so that actually he received nothing at the time of the foreclosure. The Circuit Court of Appeals, Third Circuit, held that the taxpayer had received nothing which could be made subject to an income tax, thereby reversing both the Commissioner of Internal Revenue and the Board of Tax Appeals which had sustained the Commissioner's position.

Circuit Judge Jones said, at page 176:

> "The petitioner's release from liability on account of the obligations of the bond, for which the agreement of April 23, 1934, provided, furnished no consideration to the petitioner and his associates for their action in surrendering the property to the mortgagee. The bond itself had already provided that the obligors' liability for the obligations of the bond should be limited to the property conveyed by the mortgage securing the bond and that no other property of the obligors should be taken in satisfaction of the bond's requirements. This limitation upon the obligee's right to recovery applied to the obligor's promise to pay taxes on the mortgaged property as well as to their promises to pay the principal and interest called for by the bond. The provision in the agreement relieving the obligors of any personal liability under the bond was no more than a repetition of what the obligee had stipulated in the bond. The agreement of April 23, 1934, did not, therefore, relieve the petitioner from anything for which he was liable to the obligee and, consequently, he received nothing in exchange for his part in turning over the mortgaged property to the mortgagee."

See also *Commissioner* v. *Green*, 126 F. (2d) 70, where the seller had not assumed or agreed to pay, was treated as

no part of the "amount realized" upon the conveyance of the mortgaged property. See also the discussion in *Stamler* v. *Commissioner*, 145 F. 2d 37.

No argument is needed to show the conflict between those decisions and the decisions of the Second Circuit in the case at bar.

There is also the line of decisions dealing with transfers of the mortgaged property to the mortgagee in lieu of foreclosure.

Bingham v. *Commissioner*, 105 F. 2d 971;
Hale v. *Helvering*, 85 F. 2d 819;
Turney's Estate v. *Commissioner*, 126 F. 2d 712.

In no such case that has been brought to our attention was the amount of the mortgage debt considered "amount realized" by the transferor, unless the transferor was liable for the debt and the debt was discharged, or unless there was a cash consideration as in *Blum* v. *Commissioner*, 133 F. 2d 447.

If Mrs. Crane had conveyed this real estate to the mortgagee, the Bowery Savings Bank, subject to the mortgage, without cash consideration, Judge Hand's statement that she "secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared", would have applied just as much as to the actual transaction, where she conveyed it to Avenue C Realty Corporation and received $2,500 in cash. Yet in the case supposed, there would have been no "amount realized" and no tax.

We fail to comprehend why the identity of the transferee, or the presence of a single peppercorn, or "six cents", or $100, or $2,500, should control whether the mortgage was part of the "amount realized" by the transferor. Undoubt-

edly, the cancellation of the debt, if there is a debt, or a release of liability, if there is liability, constitutes property received. But where the debt remains and no liability is released or discharged, the decision that the mortgage was "amount realized" in the case at bar, was inconsistent with the decisions of the other circuits, holding that it is not "amount realized" where the transferee happens to be the mortgagee.

We do not disagree with those decisions which refuse to superimpose the burden of an income tax upon an owner who has suffered the disaster of losing his property.

We submit—and we do not see how it can be validly controverted—that the decision of the Circuit Court of Appeals in the case at bar is in conflict with all such cases yet decided in the various federal appellate courts of the country.

IV.

The decision and judgment of the Circuit Court of Appeals was contrary to the settled law of the State of New York in which the mortgaged real estate was situated.

The distribution of the mortgaged real estate to Mrs. Crane under the residuary clause of her husband's will did not impose upon her a personal liability for the debt. This was found by the Tax Court, and the Circuit Court of Appeals concurred.

Under the law of New York, the real estate was the primary source of payment of the mortgage debt, and Mrs. Crane in no event was liable for a deficiency judgment.

Hauselt v. *Patterson*, 124 N. Y. 349, 357.

When Mrs. Crane sold the property subject to the mortgage, no change in the mortgage relationship occurred. She was under no liability before the sale, and she was under no liability afterward. The mortgaged property continued to be the primary source for the payment of the mortgage debt regardless of the change of ownership. The purchaser assumed none of the obligations of the mortgage. The position of the mortgagee remained unchanged, and could not be affected by a transaction to which he was not a party.

This was the well settled law of New York.

Belmont v. *Coman*, 22 N. Y. 438;
Dingeldein v. *Third Avenue R. R. Co.*, 37 N. Y. 575;
People ex rel. Banner Land Co. v. *State Tax Commission*, 244 N. Y. 159.

Consequently, when the Circuit Court of Appeals injected into this simple and common transaction a new element which would in effect momentarily satisfy and discharge the existing mortgage and substitute a new one, thereby bringing into existence a property right valued at $255,000, the Court created a novel concept, unknown to the law of New York and contrary to its firmly established decisions.

Smith v. *Truslow*, 84 N. Y. 660, 662.

Even if we should assume for the purpose of argument the correctness of the Court's theory of property rights arising from the sale, the value of $255,000 attributed to the "property" which Mrs. Crane was held to have received, cannot be sustained under the law of New York.

Such valuation can only be based on the assumption that the "liabilty" so "discharged" was $255,000. (Actu-

ally, it was $270,857.71 if we add to the mortgage principal of $255,000 for which Mrs. Crane was not liable, the mortgage interest of $15,857.71, for which she also was not liable and which she never received.)

The law of New York, however, in its mortgage moratorium statute forbids liability in such unconscionable amounts, and in the case of a moratorium mortgage such as this, executed prior to July 1, 1932, provides that a deficiency judgment, if granted, shall be the amount due on the mortgage with interest and costs less the market value as determined by the Court, or the sales price upon the foreclosure sale, whichever is greater (Civil Practice Act, Sec. 1083-a).

It is self-evident that even if Mrs. Crane had been personally liable on the bond and mortgage, no deficiency judgment could have been recovered against her. *Heiman* v. *Bishop*, 272 N. Y. 83.

When, therefore, the Circuit Court of Appeals held that Mrs. Crane by reason of the sale received "property (other than money)" having a "fair market value" of $255,000, it disregarded those salutary New York statutes enacted for the purpose of preventing the assertion of any such claim.

The decision of the Second Circuit was contrary to local law and should be reviewed by this Court.

V.

Mrs. Crane received no income within the meaning of the 16th Amendment except the sum of $2,500 on which she paid an income tax. The determination of the Second Circuit Court that she received income of $24,031.45, if required by the Revenue Act, violated Article I of the Constitution and the 5th Amendment thereto.

The shocking injustice of imposing an "income" tax of $1,932.99 upon a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received the sum of $2,500, compels consideration of the constitutional safeguards enjoyed by American citizens against arbitrary impositions of this character.

It is well settled that the 16th Amendment did not enlarge the field of taxation open to Congress under Article I, Section 8 of the Constitution, but simply removed in the case of a tax on income the restrictions as to uniformity and apportionment imposed upon the taxing power of Congress by Section 9 of that Article.

We may concede that the power of Congress to tax its citizens has few, if any, limits. We may even grant, at least for the purpose of this argument, that Congress has power under the Constitution to make a capital levy for the support of the Government.

But in such case, as in the case of every tax under Article I of the Constitution, except only an income tax as to which special provision is made in Amendment 16, the requirements as to uniformity and apportionment among the several States must be observed.

Pollock v. *Farmers Loan & Trust Co.*, 158 U. S. 601.

Therefore, if the Revenue Act of 1938 should be so construed as to characterize as "income" a fictitious figure which is not, in fact, income, derived by the use of mathematical imaginaries, a tax on such "income" cannot claim the protection of the 16th Amendment, and must fall because the requirements of Article I were not followed.

Eisner v. *Macomber*, 252 U. S. 189.

Applying these firmly established principles to the case at bar, a construction of the Revenue Act of 1938 which would attribute to Mrs. Crane a "gain" or "income" in excess of $2,500, could not meet the test of constitutionality.

Bowers v. *Kerbaugh-Empire Co.*, 271 U. S. 170;
Edwards v. *Cuba Railroad Company*, 268 U. S. 628;
Nicholas v. *Fifteenth Street Investment Company*, 105 F. (2) 289.

The meaning of the word "income" in the 16th Amendment is the same as when used in common speech.

Eisner v. *Macomber* (*supra*), at p. 207;
Sprouse v. *Commissioner*, 122 F. (2) 973, aff'd. 318 U. S. 604.

The action of a majority of the Second Circuit in the case at bar in transforming into a highly profitable transaction, an event which, in the ordinary meaning of language and by all dictates of common sense, was a ruinous disaster, emphasizes anew the need of the individual citizen for those safeguards against arbitrary governmental action

as established by the Bill of Rights and contained in the limitations of the Constitution.

When Mrs. Crane is singled out and told that her gain was $24,031.45 which she did not receive, instead of $2,500 which she did receive, if the statute justified the Court's decision, the need for constitutional protection is clear. If Mrs. Crane is treated thus, why should not her fictitious "income" be $240,314.50 or $2,403,145? Or any sum of money which approves itself to the Commissioner's fancy?

We respectfully submit that the alleged gain of $24,031.94 was not "income" within the meaning of the 16th Amendment, as laid down in the decisions of this Court cited under this point heading. The levying of a tax thereon was not an income tax within the purview of the 16th Amendment, but was, in fact, a capital levy made without apportionment and without regard to any census or enumeration, and consequently violated Article I, Section 9, and the 5th Amendment to the Federal Constitution.

VI.

Upon the grounds stated in the petition, and in this brief, a writ of certiorari should be granted to review the determination of the Circuit Court of Appeals in this case.

Respectfully submitted,

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FILE COPY

IN THE

Supreme Court of the United States

OCTOBER TERM 1946.

No. 68.

BEULAH B. CRANE,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR THE PETITIONER.

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IN THE

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No. 68.

BEULAH B. CRANE,

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COMMISSIONER OF INTERNAL REVENUE,

Respondent.

BRIEF FOR THE PETITIONER.

The Opinions Below.

The opinion of the Tax Court of the United States (R. 34-45) is reported in 3 T. C. 585. The opinion of the Circuit Court of Appeals (R. 53-57) is reported in 153 F. 2d. 504.

Jurisdiction.

The jurisdiction of this Court is invoked under Sec. 240(a) of the Judicial Code as amended (8 F. C. A., Tit. 28, at 347).

This proceeding involved alleged additional income taxes for the calendar year 1938. The 90-day letter of the Commissioner of Internal Revenue determining a deficiency of $1,932.99 was mailed on January 5, 1942. The petition to the Tax Court of the United States (then Board of Tax Appeals) was filed on April 1, 1942. The findings of fact and opinion of the Tax Court were promulgated on

April 7, 1944. The decision of the Tax Court determining a deficiency of $27.77 was entered on May 19, 1944. On August 16, 1944 the Commissioner filed his assignments of error and petition for review by the Circuit Court of Appeals of the United States for the Second Circuit. The decision of that Court reversing the Tax Court was rendered on December 28, 1945. The petition for a writ of certiorari was filed on March 25, 1946 and was granted on April 29, 1946.

Statement of the Case.

The facts were simple and undisputed.

William M. Crane, a resident of the State of New York died on January 11, 1932. At the time of his death he owned real estate in Brooklyn, New York, improved by an apartment house. The real estate was subject to a consolidated mortgage then in default, made by Rell Realty Company and held by the Bowery Savings Bank of New York. There was due upon it at the time of his death principal of $255,000 and interest in arrears of $7,042.50, or a total of $262,042.50. The value of the real estate as appraised in federal estate tax proceedings was $262,042.50 (Stip., R. 15; Findings, R. 36).

Under the residuary clause of Mr. Crane's will, the property passed to his wife, Beulah B. Crane, the petitioner herein (Stip., R. 15; Will, Ex. A, p. 17). She did not assume the mortgage and was not liable upon it or obligated to pay it in any way (Stip., R. 15; Findings, R. 37; see also R. 54). During all of the time she owned the apartment house, the net rents were paid to the Bowery Savings Bank under an assignment of rents and were applied to the interest due on the mortgage (Stip., R. 16; Findings, R. 36; Exs. F to J, pp. 23-26). Mrs. Crane received no income from the property (Stip., R. 16).

Between 1932 and 1938, Mr. Crane's estate in its income tax returns for 1932 and 1933, and Mrs. Crane in her income tax returns for subsequent years showed deductions for depreciation on the building of $25,500 (Findings, R. 37). Such deductions were greater than the income from all sources otherwise taxable, and the tax benefit to the estate and to Mrs. Crane was only a nominal amount. (Income tax returns received in evidence, not printed.)

In October, 1938, in order to avoid foreclosure (Stip., R. 16; Findings, R. 36), Mrs. Crane made a contract to sell her equity in the property for $3,000 (Ex. K, pp. 26-32). The contract provided:

> "The purchase price is Three Thousand Dollars ($3,000) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes, or meter charges hereinabove referred to" (R. 29).

On November 29, 1938, Mrs. Crane conveyed the real estate to the purchaser subject to the foregoing mortgage, upon which, as previously stated, she was not liable (Findings, R. 37; Deed, Ex. L., pp. 32-33). The purchaser did not pay or assume or agree to pay the mortgage (Findings, R. 40). At that time, the amount due on the mortgage was $255,000 of principal and $15,857.71 of interest, or a total of $270,857.71 (Findings, R. 36).

Mrs. Crane received $3,000 in cash. She received no release of the mortgage debt. Expenses of sale were $500 (Stip., R. 17). "The amount realized by the petitioner from sale, therefore, was $3,000 less the $500 paid for conveyancing, or $2,500" (Findings, R. 42).

The foregoing facts were found by the Tax Court (with the exception of the amount of her tax benefit, which was shown by the oral testimony and exhibits not printed in the

present record, but as to which the Tax Court made no finding one way or another).

In her income tax return for 1938, Mrs. Crane reported a capital gain of $2,500 (R. 37-38). The Commissioner of Internal Revenue claimed that the taxable gain was $23,767.03, divided between ordinary gain of $24,031.45 on the building 100% of which was recognized and capital loss of $528.85 on the land 50% of which was recognized (R. 38).

The Tax Court found that Mrs. Crane's gain was $2,500, apportioned between the land and building in proportions stipulated by the parties; that her unadjusted basis was zero which was not capable of reduction for depreciation below zero; that she received only $2,500; that the mortgage of $262,042.50 upon which she was not liable formed no part of the consideration received or "amount realized" by her (R. 34-45). The Tax Court also held that since Mrs. Crane's cost and basis was zero, she was not entitled to deduct depreciation in the year 1938 before the Court (R. 43).

Judge Tyson wrote the opinion of the Tax Court which was reviewed by the full Court. Judges Smith and Disney dissented without opinion (3 T. C. 585).

This resulted in a deficiency of $27.77 (R. 45) from which the Commissioner filed a petition for review to the Circuit Court of Appeals, Second Circuit. No petition or cross-petition for review was filed by Mrs. Crane from that portion of the decision adverse to her, denying deduction for depreciation.

The Circuit Court of Appeals, Second Circuit, reversed the Tax Court and, without discussing the figures, sustained the Commissioner's determination, viz.: that Mrs. Crane's gain was $23,767.03; that her unadjusted basis was $262,042.50; that her adjusted basis was $234,997.40; and that the amount realized was $257,500, which included the

cash of $2,500 and the principal amount due on the mortgage (R. 53-57).

Circuit Judge Learned Hand wrote the opinion in which Circuit Judge Frank concurred. Circuit Judge Swan dissented and voted to affirm upon the opinion of the Tax Court (153 F. 2d 504).

Assignment of Errors.

The assigned errors of the Circuit Court of Appeals which the petitioner intends to urge are the following:

(1) In holding that the findings of the Tax Court of the United States as to the amount realized, the basis of the property sold and the amount of the gain were not conclusive upon the Circuit Court of Appeals, and in reversing them and substituting contrary findings of its own.

(2) In holding that the principal amount due on the defaulted mortgage of $255,000, which was a lien upon the real estate when Mrs. Crane inherited it and for the payment of which Mrs. Crane was not liable under the law of the State of New York, was part of the "amount realized" by Mrs. Crane from the sale; specifically, that the "amount realized" was $257,500 as claimed by the Commissioner and not $2,500 as found by the Tax Court.

(3) In holding that the "unadjusted basis" of the mortgaged real estate received by Mrs. Crane under her husband's will was not the value of the equity but was the value of the real estate free and clear of the mortgage; specifically, that the "unadjusted basis" was $262,042.50 as claimed by the Commissioner and not zero as held by the Tax Court.

(4) In holding that the imposition of an "income" tax on a fictitious "gain" of $23,767.03 when

in fact Mrs. Crane only received $2,500, was authorized by Article I, Section 8 and the 16th Amendment of the Constitution and did not violate Article I, Section 9 and the 5th Amendment of the Constitution.

(5) Related to the foregoing and probably involved in the argument in this Court is the question whether the "unadjusted basis" of zero can be reduced through the deduction of depreciation so as to create a fictitious "adjusted basis" of a minus quantity; or, specifically, whether the "adjusted basis" for gain or loss was zero, as held by the Tax Court, or minus $28,945.10 as claimed by the Commissioner. Alternatively, as suggested by the Circuit Court of Appeals upon the argument, whether depreciation on the building should be included in the "amount realized" upon the sale in 1938 and if so, whether the amount to be included was the depreciation "allowed or allowable", or only the depreciation which resulted in tax benefit for Mrs. Crane.

SUMMARY OF THE ARGUMENT.

Preliminary Point.

The statutory formula for determining gain and loss is simple. Section 111(a) of the Revenue Act of 1938 provides that two elements are to be considered, viz.: the "amount realized" from the sale and the "adjusted basis". If the "amount realized" is greater than the "adjusted basis", there is a gain; if it is smaller, there is a loss. In computing the "adjusted basis" under Section 113(b), it is necessary first to establish the "basis" under Section 113(a) and then "adjust" that "basis" in accordance with other provisions of Section 113(b).

From these provisions and the definitions of the "amount realized" and the "basis", it clearly appears (a) that under no circumstances can the gain exceed the "amount realized"; (b) that the function of depreciation in the stautory formula is solely to reduce the "unadjusted basis", and that it cannot be used to increase the "amount realized"; and (c) that depreciation cannot be used to reduce the "basis" below zero.

(1).

The reversal of the Tax Court by the Second Circuit was a glaring violation of the rule of this Court in *Dobson* v. *United States,* 320 U. S. 489. The findings upon which the decision of the Tax Court was based were not subject to review by the Circuit Court of Appeals.

The Tax Court made affirmative findings as to (a) the amount realized, (b) the unadjusted basis, and (c) the adjusted basis, and, applying the statutory formula, computed a gain of $2,500. These findings, and particularly the finding that the "amount realized" by Mrs. Crane did not exceed $2,500, were conclusive on the Circuit Court of Appeals.

Furthermore, the evidence before the Tax Court, largely in the form of a stipulation of facts, which showed that the mortgagee received all of the net rents, that Mrs. Crane received no income or benefit from her ownership, that the interest defaults were steadily increasing and that Mrs. Crane's sale was a desperate salvage operation entered into to avoid foreclosure, conclusively sustained the Tax Court's conclusion that her gain was only $2,500.

The counter-findings of the Second Circuit that the amount realized was $257,500, that the basis was $262,048.50

and that the gain was $24,031.45 were contrary to the evidence and had nothing in the record to sustain them.

(2).

The Second Circuit erred in holding that the principal amount due on the defaulted mortgage of $255,000 which was a lien on the real estate when Mrs. Crane inherited it, and for the payment of which Mrs. Crane was not liable, was part of the "amount realized" by Mrs. Crane upon the sale.

Under the law of New York in which the mortgaged real estate was situated, when real estate is sold subject to a mortgage on which the vendor is not personally liable and which is not assumed by the purchaser, the primary source of payment of the mortgage debt, both before and after the sale, is the land itself. The bond and mortgage and the individual rights and liabilities in respect to the mortgage are not affected by the sale. The Bowery Savings Bank had no right to proceed personally against Mrs. Crane or the purchaser, either before or after the sale, and its right to a deficiency judgment against the Rell Realty Corporation, or whatever person might be liable for the payment of the mortgage, was not and could not be affected by the sale. Mrs. Crane received no property, consideration or benefit whatsoever from the sale, except the sum of $2,500 on which she paid a tax.

The argument of the Second Circuit that the transaction was the same as if the purchaser had paid Mrs. Crane $257,000 in cash and required her to satisfy the old mortgage, or as if the seller had agreed to pay off a mortgage on other real estate which Mrs. Crane retained, was entirely unsound. In the cases supposed by the Court new rights and obligations were assumed to have been contracted for

and entered into, while in Mrs. Crane's case there were none. In no sense did the sale relieve Mrs. Crane of any liability or confer upon her any benefit or property beyond the $2,500 cash received.

Furthermore, under the New York mortgage moratorium statutes the liability of a person bound for the payment of a mortgage debt is limited to the difference between the mortgage debt, and the fair and reasonable market value of the real estate or the amount realized on a foreclosure sale, whichever is smaller. Even if relief from such alleged liability be regarded as "property (other than money) received", its "fair market value" under no circumstances could be the full amount of the mortgage debt, and in the present case would have only nominal value.

(3).

The Second Circuit erred in holding that the "unadjusted basis" of the property received by Mrs. Crane under her husband's will was the value of the real estate free and clear of the mortgage, and in adjusting this basis by the amount of depreciation allowed or allowable in previous years. The "unadjusted basis" of the mortgaged real estate was the value of Mrs. Crane's equity which the Tax Court held to be zero. Such unadjusted basis can not be reduced to a minus quantity by the deduction of depreciation.

Section 113(a)(5), which provides that, in the case of property transmitted at death, the basis should be "the fair market value of such property at the time of such acquisition" and the established Treasury practice which fixes this value as the federal estate tax valuation can only rest on the theory that, for the purpose of gain or loss, the property sold by the devisee is the same property as that received

from the decedent. In the case of mortgaged real estate, the property received is only the equity of redemption and its value must be the value of the equity, not the value of the real estate free and clear of the mortgage. This is recognized by the estate tax return and the regulations governing it. Similarly, for the purpose of other taxable transfers, as the gift tax and the stamp tax, the value of the property taxed is the value of the equity.

The Second Circuit's contrary holding, that the "property" received is the real estate free from the mortgage, is founded upon ancient concepts as to the necessity of continuous seizin which obscures the fact that in reality the "property" which Mrs. Crane received under her husband's will and sold in 1938 was her equity in mortgaged real estate.

The Second Circuit also erroneously endeavored to force into the formula for gain or loss an amount based on physical depreciation of the apartment house. This was error, because for tax purposes depreciation is based on the taxpayer's cost, which in this case was zero.

The Tax Court disallowed depreciation in 1938 from which determination no appeal was taken. Therefore, it is the law of the case that depreciation was erroneously claimed by Mrs. Crane and allowed by the Commissioner for 1932-1938. This joint error, which cannot now be corrected because of the statute of limitations, supplies no justification for the effort to offset it by committing a further error in the elements of the gains tax. In addition, by trying to avoid a double deduction in Mrs. Crane's case, the Second Circuit has opened the door to many taxpayers to obtain double deductions.

There is no occasion to distort the statute. It does not compel straight line depreciation, but simply a "reasonable

allowance". In cases such as this, where there is a zero equity, the loss because of physical wear and tear actually falls upon the mortgagee, not the title holder. No reason exists for allowing a deduction to the title holder who suffers no loss. The proper application of this principle answers the problem of sales by foreclosure, or by deed in lieu of foreclosure, where common sense shows there should be no tax. It avoids the necessity of holding such a sale taxable or exempt depending upon the identity of the transferee or the presence or absence of trivial monetary consideration.

(4).

Mrs. Crane received no income within the meaning of the 16th Amendment, except the sum of $2,500 on which she paid an income tax.

The levy of an "income" tax of $1,932.99 upon a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received the sum of $2,500, demonstrates that this tax cannot be sustained under the 16th Amendment, but was in the nature of a capital levy subject to the requirement of uniformity and apportionment imposed upon the taxing power of Congress by Section 9 of Article I.

ARGUMENT.

Preliminary Point.

The statutory formula for determining gain or loss was simple. Section 111(a) of the Revenue Act of 1938 which governed the tax for the year in question provided:

> "(a) *Computation of Gain or Loss.* The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over

the adjusted basis provided in section 113(b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized."

Section 113(b) provided:

"(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided."

In other words Section 111(a) provided that in computing gain or loss only two elements were to be considered, viz.: (1) the "amount realized" from the sale; and (2) the "adjusted basis" provided in Section 113(b). If the "amount realized" from the sale was greater than the "adjusted basis", there was a gain; if it was smaller, there was a loss.

Similarly, in computing the "adjusted basis" under Section 113(b), it was necessary first to establish the "basis" as defined in Section 113(a) and then "adjust" that basis in accordance with other provisions of Section 113(b).

Those three elements, viz.: the "amount realized", the "basis" and the method of computing the "adjusted basis" were all clearly defined by statute, thus:

(1) The "amount realized" was defined in Section 111(b) as follows:

"(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received."

(2) Subdivision (5) of Section 113(a) defined the "basis" to be used in this case. It read:

> "(5) *Property Transmitted at Death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition."

(3) The method of determining the "adjusted basis" was laid down in subdivision (1) of Section 113(b) as follows:

> "(1) *General Rule.*—Proper adjustment in respect of the property shall in all cases be made—
>
> (A) . . .
>
> (B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws."

From these clear and simple statutory provisions, three principles inescapably follow: (a) that under no circumstances can the "gain" exceed the "amount realized"; (b) that the function of depreciation in the statutory formula is solely to reduce the "unadjusted basis" and that the statute does not permit depreciation to be applied to increase the "amount realized"; and (c) that depreciation cannot be used to reduce the "basis" below zero, so as to produce an arithmetical imaginary such as a minus basis.

With this background, we shall proceed to the argument.

POINT I.

The reversal of the Tax Court by the Second Circuit was a glaring violation of the rule of this Court in *Dobson* v. *United States*, 320 U. S. 489. The findings upon which the decision of the Tax Court was based were not subject to review by the Circuit Court of Appeals.

The Tax Court made the following findings:

(a) *As to the amount realized.*

"The facts show and the respondent (Commissioner) concedes, that petitioner received money to the extent of only $2,500 from the sale" (R. 41).

"As she (Mrs. Crane) was never under any personal obligation to pay the mortgage debt she received no consideration whatever when she sold and conveyed the property subject to the mortgage, except the $2,500 in money mentioned above" (R. 41).

"Except for the $2,500, the petitioner thus did not receive money, or the equivalent of money, or property (other than money) having fair market value" (R. 41).

"The amount realized by the petitioner from the sale, therefore, was $3,000 less the $500 paid for conveyancing, or $2,500" (R. 42).

(b) *As to the unadjusted basis.*

"The property when acquired by the petitioner was encumbered by a mortgage in an amount which, together with the accrued interest thereon, was equal to the fair market value of the property" (R. 42).

"The interest of petitioner in the apartment house property had no fair market value whatever when acquired by her" (R. 42).

(c) *As to the adjusted basis.*

"We have *determined* that the unadjusted basis of the property in question, under Section 113(a)(5), is zero, and, this being true, there is, in the very nature of things, nothing to adjust—nothing from which depreciation can be deducted" (R. 43).

(d) *The Tax Court's computation.*

"We conclude and so hold that the proper basis to be used in computing petitioner's gain is zero, and, as the amount realized by her from the sale of the property was only $2,500, that her gain from the sale is in the same amount" (R. 43).

Having thus found as a fact that the minuend was $2,500 and that the subtrahend was zero, the ascertainment of the gain of $2,500 and the computation of the tax thereon was a simple arithmetical problem.

These findings, and particularly the finding that the "amount realized" by Mrs. Crane was $2,500, should have ended the case. No counter-finding of fact or counter-conclusion of law by the Circuit Court of Appeals was permissible under the law to reverse the Tax Court's judgment.

The Circuit Court of Appeals with Circuit Judge Swan dissenting took a different view. Premising its remarks with the following observation:

"The appeal does not concern the figures; it only raises the question whether the taxpayer is right—as the Tax Court held, two judges dissenting—in insisting that the only gain for which she was taxable was the $2,500 which she received upon the sale" (R. 54),

the Second Circuit substituted for the Tax Court's findings, the following findings of its own:

(a) *As to the amount realized.*

"When therefore upon a sale the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared, or as though it were a condition upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received 'property (other than money)'; yet the effect is precisely the same as the transaction at bar" (R. 55-56).

In figures this meant that the fair market value of the amount realized by Mrs. Crane was $257,500.

(b) *As to the unadjusted basis.*

"Section 113(a)(5) defines the 'unadjusted basis' of property in the case of a devisee as its 'fair market value' when it was acquired, which in the case at bar was its appraised value as part of the devisor's estate" (R. 54).

This made the unadjusted basis $262,042.50.

(c) *As to the adjusted basis.*

"We canot doubt, especially in view of the long uniform practice, that the right 'basis' for depreciation is the actual value of the buildings" (R. 55).

The depreciation so computed was $28,045.10 which gave a figure of $178,997.40 as the adjusted basis of the building, and $55,000 for the land (R. 38).

(d) *The Second Circuit's computation.*

As stated, the Circuit Court of Appeals did not concern itself with figures. The Commissioner's computation, thus approved by the Circuit Court of Appeals, showed an ordi-

nary gain of $24,031.45 for the buildings, 100% of which was recognized, and a capital loss of $528.85 for the land, 50% of which was recognized (R. 38).

In reversing the Tax Court's findings, and substituting findings of its own, and adopting the computations of the Commissioner, the Second Circuit committed a clear violation of the rule of the *Dobson* case.

Matters relating to gain or loss and the basis for the purpose of determining gain or loss, including the amount which was realized on the sale and the allowance, if any, for depreciation, are essentially matters for determination by the "body of experts" (H. Rep. No. 1, 69th Cong., 1st Sess., p. 19) comprising the Tax Court of the United States. *Dobson* v. *United States, supra; McDonald* v. *Commissioner,* 323 U. S. 57, 64; *John Kelley Co.* v. *Commissioner,* 326 U. S. 521.

Even if the determination of such elements might not be regarded pure finding of facts, it fell within that class of mixed questions of fact and law which this Court held in the *Kelley* case were exclusively for determination by the Tax Court and not subject to review by the Circuit Court of Appeals.

Indeed, the language which this Court used in the *Kelley* case might well have been spoken in the case at bar. For instance:

> "There would hardly need to be experts in tax affairs to decide questions of dates or amounts or values or to calculate rates. Their usefulness lies primarily in their ability to examine relevant facts of business to determine whether or not they come under statutory language" (p. 529).

The Tax Court had before it the following stipulated facts:

"(11) That at all times between February 1, 1932 and November 29, 1938, the said mortgage was in default for non-payment of interest, and that petitioner entered into an arrangement with the Bowery Savings Bank whereby the net income from the premises should be paid to the Bowery Savings Bank on account of the mortgage * * *" (R. 16).

"(12) That pursuant to such arrangement the petitioner paid over to the Bowery Savings Bank the net income received from the premises for each calendar year from 1932 to 1938, inclusive" (R. 16).

"(13) That for the purpose of the arrangement between the petitioner and the Bowery Savings Bank, the net income was computed without allowance for depreciation" (R. 16).

"(14) That in the year 1938 the mortgage on the premises held by Bowery Savings Bank was in default for non-payment of principal, interest and taxes in amounts approximately as follows:

Principal	$255,000.00
Interest	15,857.71" (R. 16).

It undoubtedly recalled that the interest default at date of death was only $7,042.50 (Stip. R. 15), and noted that during the intervening six years Mrs. Crane received not a single dollar or item of benefit whatsoever from her ownership, and that the interest default had increased to $15,857.71.

The Tax Court had before it the following stipulated fact:

"(15) That in order to avoid foreclosure of the mortgage, petitioner entered into a contract with Avenue C Realty Corporation, a copy of which is annexed hereto and marked Exhibit K" (R. 16).

By the Commissioner's own concession, this was not an ordinary business transaction or one entered into for profit, but was a forced sale, made under compulsion in order to avoid foreclosure of the mortgage.

The Tax Court likewise had before it the contract of sale (Ex. K, pp. 26-32) which contained the following clause (R. 29):

> "The purchase price is Three Thousand Dollars ($3,000) for the equity conveyed by the seller and without deduction for the mortgage principal, interest or taxes or meter charges hereinabove referred to; * * *".

It had before it the conceded fact that Mrs. Crane was not personally liable for the payment of the bond and mortgage, including both principal, interest, real estate taxes and other incidents (R. 15).

On these undisputed facts, the finding of the Tax Court that the amount realized by Mrs. Crane was only $2,500 after expenses and that the principal of the mortgage was not "property (other than money) received", followed irresistably and inevitably. No other conclusion was possible upon the stipulation and uncontroverted evidence.

Quite apart from the *Dobson* case, the findings and decision of the Circuit Court of Appeals were contrary to the evidence and should be reversed.

Under the ruling of this Court in the *Dobson* case and in the *Kelley* case, it seems to us too clear for argument that Congress assigned the determination of questions such as this to the exclusive jurisdiction of the Tax Court and denied to the Circuit Court of Appeals or any other Appellate Court the jurisdiction and power to reexamine the issues and substitute contrary findings.

If the decision of this Court in *John Kelley Co.* v. *Commissioner* had preceded the decision of the Circuit Court of Appeals in this case, or had been brought to its attention, it is inconceivable that the Second Circuit would have reversed the Tax Court. Any doubt in the minds of the Circuit Judges whether the *Dobson* case was still law, or what effect should be given to it, would have been dispelled by the emphatic language of this Court in the *Kelley* case.

Such flagrant disregard of the *Dobson* rule requires the reversal of the judgment of the Second Circuit and the reinstatement of the determination of the Tax Court.

POINT II.

The Second Circuit erred in holding that the principal amount due on the defaulted mortgage of $255,000, which was a lien upon the real estate when Mrs. Crane inherited it and for the payment of which Mrs. Crane was not liable, was part of the "amount realized" by Mrs. Crane upon the sale.

We repeat the statutory definition found in Section 111(b), viz.:

> "(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received."

Reg. 111, Sec. 29.111-1 says:

> "The amount realized from a sale or other disposition of property is the sum of any money received plus the fair market value of any property which is received. The fair market value of property is a question of fact, but only in rare and extraordinary

> cases will property be considered to have no fair market value."

The question is, therefore, (1) What, if any, property other than money did Mrs. Crane receive? and (2) What, if anything, was the fair market value of such property?

Accepting the finding of the Tax Court that Mrs. Crane was not a party to the mortgage or to the bond which secured it, and that she did not at any time assume any personal liability upon the bond or mortgage (R. 37), the Circuit Court of Appeals said (R. 54):

> "Although the taxpayer was the devisor's sole legatee, the Commissioner does not suggest that she was liable upon his bond, if indeed he was himself liable. The case is therefore to be decided on the assumption that her only relation to the mortgagee was that as devisee of the land, she took it encumbered by the lien of the mortgage."

Upon this agreed state of facts, the rights and liabilities of the title holder and of the mortgagee under the law of New York where the mortgaged premises were situate, were well settled and clear.

Mrs. Crane's ownership of the real estate was subject and subordinate to the lien of the mortgage; she had the right to possession of the mortgaged premises unless she voluntarily relinquished possession by sale or other transfer, or involuntarily lost it by foreclosure. *Barson* v. *Mulligan*, 191 N. Y. 306, 315, 316. She had in fact surrendered to the mortgagee the right to the rents, profits and other income, thus making the Bowery Savings Bank virtually a mortgagee in possession and leaving herself only the equity of redemption. *Barson* v. *Mulligan, supra; Becker* v. *McCrea*, 193 N. Y. 423, 428. She could only reacquire the right to receive and enjoy the income of the apartment house by curing the default. *Tiernan* v. *Marsh*, 54 N. Y. 599, 606.

Those were her rights and privileges. As for liabilities, she had none. She was not liable at law or in equity for the mortgage debt, or for the performance of any covenants of the mortgage either by contract (R. 37, 54), as devisee, *Hauselt* v. *Patterson*, 124 N. Y. 349, 357, or as owner *Smith* v. *Truslow*, 84 N. Y. 660, 662. In the City of New York there is no personal liability upon the owner for the payment of real estate taxes. *New York City Charter*, Section 155, *et seq.*

The Bowery Savings Bank as mortgagee had the right to enforce payment of the mortgage debt, including principal, interest, arrears of taxes, and advances it may have made to protect the mortgage, primarily out of the real estate by means of foreclosure and sale, and secondarily, subject to statutory limitations, against the individuals personally liable for the mortgage debt by means of deficiency judgment. *Chase National Bank* v. *Guardian Realties, Inc.*, 283 N. Y. 350, 361; *Matter of Wilbur* v. *Warren*, 104 N. Y. 192, 197. But the Bank had no rights against Mrs. Crane. *Belmont* v. *Coman*, 22 N. Y. 438; *Elliott* v. *Sackett*, 108 U. S. 132; *Shepherd* v. *May*, 115 U. S. 505.

When Mrs. Crane contracted to sell her equity in the real estate (R. 29) and conveyed it to the Avenue C Realty Corporation subject to the mortgage and unpaid taxes, she received $2,500 in cash and conveyed to the purchaser all of her rights above enumerated. Beyond that she received nothing whatsoever of any kind or nature, directly or indirectly, whether positively by way of tangible or intangible property or choses in action, or negatively by being released or indemnified from some actual or contingent or supposed liability on the mortgage.

While the purchaser agreed to accept a conveyance "subject to" the mortgage, the purchaser did not by contract, deed, or otherwise, assume or agree to pay the mort-

gage debt or any part thereof. (Contract, Ex. K, pp. 26-32; Deed, Ex. L, pp. 32-34) *Dingeldein* v. *Third Avenue Railroad Co.*, 37 N. Y. 575, 577; *Belmont* v. *Coman*, *supra*.

Analyzing and summarizing the rights and liabilities of the parties before and after the sale, we find the following situation:

Party	Before	After
Mrs. Crane	*Rights:* Usual incidents of ownership above stated, with exception noted.	$2,500 (after expenses)
	Liabilities: None.	No change.
Bowery Savings Bank	*Rights:* Primary against the land; secondary against individuals, if any, personally liable, not including Mrs. Crane, or purchaser.	No change.
	Liabilities: None.	No change.
Purchaser	*Rights:* $3,000 (in bank).	Same incidents of ownership enjoyed by Mrs. Crane as above stated, with same exception noted.
	Liabilities: None.	No change.

The theory which the Commissioner urged upon the Circuit Court of Appeals and upon this Court, in arguing that Mrs. Crane received "property (other than money)" valued at $255,000, was stated in his brief, thus:

> "She • • • was obliged to pay interest on the mortgage as long as she held the property. • • • She was relieved of these obligations when she sold the property, subject to the mortgage, and thus the cash alone is not the full measure of the consideration she received. In the absence of any evidence to the contrary as to the value of these benefits, it would seem reasonable to value them in the amount of the principal of the mortgage, because that figure represents the capitalized value of her obligation."

Flatly and categorically, the foregoing assertion by the Commissioner is entirely unsupported by the evidence, by the stipulation between the parties and by the findings of the Tax Court, and is unqualifiedly contrary to the fact.

Nothing could be clearer than that Mrs. Crane was *not* obliged to pay interest on the mortgage. The sale of her interest in the real estate did *not* relieve her of any obligation arising under the mortgage or the mortgage bond because she was never under any such obligation. She did *not* receive any release from the obligation of the mortgage. None was ever executed or delivered. Mrs. Crane needed none because she was under no obligation. Furthermore, even if she had been under such a liability, the sale would *not* have affected it in the slightest. Many a person liable on a mortgage has had a deficiency judgment taken against him long after he has sold the mortgaged real estate, and after it has changed hands many times.

The Commissioner's argument is simply this: If I own a horse and sell it for $100, the "amount realized" is not only the $100 paid by the buyer in cash but also the value of the hay, oats and straw which I would have had to buy if I had continued to own the horse and desired to keep it alive, from which I have been "relieved" because I sold it! This is the same kind of "benefit" that a highwayman graciously confers when he "relieves" the traveller of the burden of carrying his watch!

The Second Circuit, adopting the substance of the Commissioner's argument, reasoned as follows (R. 55):

> "The mortgagee is a creditor, and in effect nothing more than a preferred creditor, even though the mortgagor is not liable for the debt. He is not the less the creditor because he has recourse only to the land, unless we are to deny the term to one who may levy upon only a part of his debtor's assets.

> When, therefore, upon a sale the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared, or as though it were a condition upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would any one question the conclusion that the vendor had received "property (other than money)"; yet the effect is precisely the same as the transaction at bar."

We cannot follow the Court's argument. Take the statement that Mrs. Crane's situation was in effect the same as if the purchaser had paid off a mortgage on another parcel of real estate owned by Mrs. Crane which she did not sell but retained. The assertion is simply not so. Continued beneficial ownership of Blackacre which had been made free and clear of mortgage cannot possibly be the same as not owning any real estate at all.

Take the other statement that Mrs. Crane's situation was in effect the same as if the contract had required the buyer to pay $255,000 in cash to the mortgagee to satisfy the mortgage. (Incidentally it would have taken at least $270,857.71 to clear the mortgage lien, R. 16, not $255,000.) Again, it simply is not so. In the case supposed, the buyer would have to obtain $255,000 in cash from somewhere—the Court did not say where—and would have received unencumbered real estate; Mrs. Crane would have received all cash and would have sold the real estate free and clear of the mortgage. The Second Circuit saw no difference between that situation and a sale of real estate subject to the mortgage. Nevertheless, the difference is a very real one, both from the buyer's point of view (because in case of a

purchase subject to a mortgage, he does not ever have to pay the principal of the mortgage or even the interest thereon, if he does not wish to do so; the land is obligated for the payment, but neither the buyer nor the seller is obligated), and from the seller's point of view (in the case of a sale free and clear of a mortgage the seller receives cash while, in the case of a sale subject to a mortgage, she receives nothing), and from the mortgagee's point of view (who in this case would have been happy to find his mortgage paid in full). All of this was carefully pointed out in *Belmont* v. *Coman, supra,* and repeated in *Dingeldein* v. *Third Avenue Railroad Co., supra, Matter of Wilbur* v. *Warren, supra,* and other cases.

Further reflection shows many other respects in which Judge Hand's second hypothetical case differs from the sale subject to the mortgage which occurred in the case at bar.

(1) It would require the consent of the mortgagee, or the procuring of a new mortgage elsewhere. Does anyone suppose that, in view of the bad record of this mortgage, the Bowery Savings Bank would be willing to place a new mortgage on the property, not merely for $255,000, but for this amount plus interest of $15,857.71? How could it legally be done in view of the statutory 60% limitation on the mortgage investments of a savings bank? (Banking Law, Sec. 235(6)(a))

(2) It would require the execution of a satisfaction piece by the Bowery and the production, surrender and cancellation of the old bond and mortgage, and the payment of filing fees.

(3) It would require a title search and a survey, and the preparation of a new bond and mortgage by an attorney, and other expenses which somebody would have to pay for.

(4) It might well have disclosed the existence of mechanics' or other liens subordinate to the Bowery mortgage which would have to be disposed of in some way before a new mortgage of equal lien could be substituted.

(5) A New York mortgage tax would have to be paid upon the new mortgage at the rate of 50¢ per $100, or at least $1,275 plus recording fees. *N. Y. Tax Law*, Sec. 253; *People ex rel. Banner Land Co. v. State Tax Commissioner*, 244 N. Y. 159, 162.

(6) There would be a new mortgagor who would be personally liable on the bond, either Mrs. Crane or the purchaser, or a dummy, and the individuals personally liable on the old mortgage would be released and discharged.

(7) The new bond and mortgage would be free from the restrictions imposed on the old bond and mortgage by the New York mortgage moratorium statutes.

This was not what was done here or contracted for. There was no Blackacre. There was no new mortgage. No mortgage was discharged. The old one continued. Neither actually, figuratively, nor by way of equivalent was there "a release from a charge upon his property". The very act which, according to Judge Hand, benefited Mrs. Crane's property to the extent of $255,000, simultaneously divested her of the property itself.

If mortgaged assets should be destroyed without insurance (I. R. C., Sec. 23e), or if they had been captured by the enemy (I. R. C., Sec. 127), Congress expressly allowed the owner to deduct the amount of his loss, presumably the value of the asset less the mortgage lien. Under the Commissioner's argument there would have been no loss, but the owner would have received a benefit equal to the mort-

gage even if he was not liable for the mortgage debt and the liability of the persons obligated had continued. According to the Second Circuit the transaction would have been precisely the same as if the enemy had paid the owner the full amount of the mortgage in cash.

Emphasizing this intention of the parties and refuting Judge Hand's argument, was the provision in the contract of sale, to which the Second Circuit did not refer, that the purchase price was $3,000 for the equity conveyed by the seller without deduction for the mortgage principal, etc. (R. 29). No clearer language could be used to show that Mrs. Crane was to receive, and did in fact receive, no money or property other than the sum of $3,000 in cash, and that the mortgage was to remain undisturbed.

Let us consider further where Judge Hand's disregard of the mortgage lien would lead. A mortgage is not the only form of encumbrance on real property which may reduce the cash purchase price payable to the seller. Suppose real property is sold subject to a restrictive covenant, or subject to an easement such as a right of way or for the flowage of water, or subject to mineral or oil or timber rights. In each case the seller is the title holder of the real estate sold. In each case the beneficiary of the restrictive covenant or holder of the easement or other right is not a co-tenant. In each case the burden is that of the land alone and no personal liability rests on the seller or purchaser. In each case the conveyance describes the property by metes and bounds, or other description, and conveys it to the purchaser "subject to" the lien in question.

In case of a sale of such property, no one would think for a minute that the seller had received in "property (other than money)" the amount by which the encumbrance had reduced the value of the real estate. Nevertheless, in the case of a mortgage lien, the Circuit Court of Appeals

believed that Mrs. Crane received in money and property (other than money) the identical amount that she would have received if she had owned and sold the property free and clear. In a word, although the mortgagee received nothing and the purchaser paid nothing, and Mrs. Crane had nothing which she could spend or use to pay a tax, still she received "property (other than money)" having a "fair market value" of $255,000 over and above the cash consideration of $2,500!

Needless to say, our research has disclosed no court (except the Second Circuit) which has taken such views. All the decisions which have come to our attention hold otherwise.

When the case at bar was argued and briefed, the opinion of the Circuit Court of Appeals, Fifth Circuit, in *Hilpert* v. *Commissioner*, 151 F. 2d 929, reversing 4 T. C. 473, had not been announced and was not available to Court or counsel.

In its essentials, there is little difference between the *Hilpert* case and the case at bar. Mr. and Mrs. Hilpert owned real estate in Florida. In consideration of $65,000 they conveyed it to a money-lender subject to a repurchase agreement exercisable at their option. The Florida court had held that this was an equitable mortgage under which they had the right to redeem. Pending the decision of the Florida court, they made a contingent contract to sell the real estate for $17,067.67 cash, and the purchaser agreed to pay the money necessary to redeem. Following the decision of the Florida court title was closed. It was conceded that the Hilperts were not liable on the mortgage. The question arose whether the redemption price was part of the "amount realized" by the Hilperts on the sale.

The Tax Court announced the same rule which it adopted in the case at bar. It said (p. 476):

> "There is no dispute as to basis. The controversy relates to the amount of the consideration. It is true that all that petitioners received upon the sale was the cash paid to them by the vendees. • • • Only when the facts are so peculiar that the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received can it safely be eliminated from the computation of gain."

For reasons not material here, the Tax Court held that the rule did not apply.

It is interesting to notice that Judges Smith and Disney, who dissented in Mrs. Crane's case, dissented from the contrary holding in the *Hilpert* case. Adopting, although belatedly, the same point of view which we have consistently advocated, the dissenting Judges said (p. 477):

> "They sold whatever rights they had under the decree of the court for a cash consideration of $17,067.67. That is all they realized from such sale. How then can it be held that they realized taxable income upon such sale of $66,399.45, a part of which was capital gain and a part ordinary income? How can an actual gain of $17,067.67 be transmuted into a taxable gain of $66,399.45?
>
> The Tax Court's holding seems to me to be entirely unrealistic. The taxpayers cannot have a taxable gain from the sale in 1939 of any greater amount than they actually received, namely $17,067.67."

The Circuit Court of Appeals, Fifth Circuit, reversed the Tax Court, and held that the amount of the mortgage or redemption price was not part of the amount realized by the Hilperts.

The Fifth Circuit said (p. 931):

> "We find no fault with the foregoing statement of legal principles but only in their application to

the peculiar facts in this case. We think that the Tax Court erred in its view as to what the Hilperts received."

It continued (p. 933):

"Since there was no note, no covenant, and no agreement to repay the $65,000, and no enforceable obligation against the Hilperts in the transaction, the Tax Court was wrong in holding that the payment of the $54,364.07 by Lawton Investment Company in redeeming the property was a benefit received by the sellers out of that purchase. The case clearly comes within the exception stated by the Tax Court that when the mortgage neither constitutes a liability of the seller nor is responsible for a part of the aggregate benefit received it is appropriate that the amount paid by another to redeem property from the mortgage should be eliminated from the computation of gain to the mortgagor.

Since there was no personal liability that could accrue against the Hilperts, all that they got out of the transaction was the $17,067.67."

It concluded (p. 933):

"We agree with the dissenting opinion in the Tax Court that the Tax Court's holding seems to be entirely unrealistic. The appetite for taxes is not so voracious, the commands of the statute are not so inexorable, as to require the doing of an injustice when there is open another course that is more fully consonant with law and reason and which course, if followed, will lead neither to evasion by the taxpayer nor extortion by the Government."

There are also the decisions in the Third Circuit.

Polin v. *Commissioner*, 114 F. 2d 174;
Commissioner v. *Green*, 126 F. 2d 70;
Stokes v. *Commissioner*, 124 F. 2d 335.

In *Polin* v. *Commissioner, supra,* the taxpayer at the time of the foreclosure of the mortgage was given a release from liability on the mortgage bond. The Commissioner claimed that thereby he had received property (other than money), equal in value to the amount due on the mortgage plus interest. It was proven, however, that the taxpayer had received a release some ten years before, so that actually he received nothing at the time of the foreclosure. The Circuit Court of Appeals, Third Circuit, held that the taxpayer had received nothing which could be made subject to an income tax, thereby reversing both the Commissioner of Internal Revenue and the Board of Tax Appeals which had sustained the Commissioner's position.

Circuit Judge Jones said, at page 176:

> "The petitioner's release from liability on account of the obligations of the bond, for which the agreement of April 23, 1934, provided, furnished no consideration to the petitioner and his associates for their action in surrendering the property to the mortgagee. The bond itself had already provided that the obligors' liability for the obligations of the bond should be limited to the property conveyed by the mortgage securing the bond and that no other property of the obligors should be taken in satisfaction of the bond's requirements. This limitation upon the obligee's right to recovery applied to the obligor's promise to pay taxes on the mortgaged property as well as to their promises to pay the principal and interest called for by the bond. The provision in the agreement relieving the obligors of any personal liability under the bond was no more than a repetition of what the obligee had stipulated in the bond. The agreement of April 23, 1934 did not, therefore, relieve the petitioner from anything for which he was liable to the obligee and, consequently, he received nothing in exchange for his part

in turning over the mortgaged property to the mortgagee."

See also *Commissioner* v. *Green*, 126 F. 2d 70, where the mortgage which the seller had not assumed or agreed to pay, was treated as no part of the "amount realized" upon the conveyance of the mortgaged property. See also the discussion in *Stamler* v. *Commissioner*, 145 F. 2d 37.

No argument is needed to show the conflict between those decisions and the decision of the Second Circuit in the case at bar.

There is also the line of decisions dealing with transfers of the mortgaged property to the mortgagee in lieu of foreclosure.

Bingham v. *Commissioner*, 105 F. 2d 971;
Hale v. *Helvering*, 85 F. 2d 819;
Turney's Estate v. *Commissioner*, 126 F. 2d 712.

In no such case that has been brought to our attention was the amount of the mortgage debt considered "amount realized" by the transferor, except where the transferor was liable for the debt and the debt was discharged, or there was a cash consideration as in *Blum* v. *Commissioner*, 133 F. 2d 447.

If Mrs. Crane had conveyed the real estate to the Bowery Savings Bank subject to the mortgage, without cash consideration, Judge Hand's statement that she "secures a release from a charge upon his property quite as though the vendee had paid him the full price on condition that before he took title the lien should be cleared", would have applied just as much as to the actual transaction where she conveyed it to Avenue C Realty Corporation and received $2,500 in cash. Yet Judge Hand concedes that, in the case supposed, there would have been no "amount realized" and no tax.

We cannot understand why the identity of the transferee, or the presence of a single peppercorn, or "six cents", or $100, or $2,500, should control whether the mortgage was part of the "amount realized" by the transferor. Undoubtedly, the cancellation of the debt, if there is a debt, or a release of liability if there is liability, constitutes property received. But where the debt remains and no liability is released or discharged, the holding that the mortgage was "amount realized" in the case at bar was inconsistent with those decisions that it is not "amount realized" where the transferee happens to be the mortgagee.

The Revenue Act used the word "received". It used the expression "fair market value". These expressions should not be passed by without notice. They mean that money or property other than money must have passed into Mrs. Crane's hands, or that she received some intangible benefit sufficiently realistic to have a fair market value. They require that whatever money or property received by Mrs. Crane having sufficient substance and value to be the incidence of an income tax, must also be sufficiently substantial and valuable to supply the wherewithal with which to pay it.

From whatever angle the transaction is viewed, Mrs. Crane received nothing, certainly nothing having a fair market value or any value at all, except the sum of $2,500 in cash. That was the amount realized—nothing more.

(2).

Even if we should assume for the purpose of argument the correctness of the Court's theory of property rights arising from the sale, the "fair market value" of $255,000 attributed to the "property (other than money)" which Mrs. Crane was held to have received, cannot be substained under the law of New York. Such valuation can only be based on the assumption that the "liability" so "dis-

charged" was $255,000. (Actually it was $270,857.71 if we add to the mortgage principal of $255,000, for which Mrs. Crane was not liable, the mortgage interest of $15,857.71 for which she also was not liable and which she never received.)

The law of New York in its mortgage mortatorium statutes forbids liability in such unconscionable amounts, and in the case of a moratorium mortgage such as this, executed prior to July 1, 1932, provides that a deficiency judgment, if granted, shall be the amount due on the mortgage with interest and costs less the market value as determined by the Court, or the sales price upon the foreclosure sale, whichever is greater (*Civil Practice Act*, Section 1083-a).

It is self-evident that, if Mrs. Crane had been personally liable on the bond and mortgage, no deficiency judgment could have been recovered against her. *Heiman* v. *Bishop*, 272 N. Y. 83.

These relevant facts and elements of value must be taken into consideration in fixing the "fair market value" of the "property" which Mrs. Crane is alleged to have "received". When examined they conclusively demonstrate that the fictitious "release" of liability was utterly valueless because the existence and enforcement of such supposed liability was barred as contrary to public policy of the State of New York.

We submit, therefore, that the Circuit Court of Appeals erred in reversing the Tax Court's finding that Mrs. Crane received only $2,500, and in including within the "amount realized" the sum of $255,000 unpaid principal of the mortgage for which Mrs. Crane was not liable and which the purchaser did not assume or agree to pay, and which was unenforceable against anybody under the mortgage moratorium statutes of New York.

POINT III.

The Second Circuit erred in holding that the unadjusted basis of the property received by Mrs. Crane under her husband's will was the value of the real estate free and clear of the mortgage, and in adjusting such basis by the amount of depreciation allowed or allowable in previous years. The unadjusted basis of the mortgaged real estate was the value of the equity which the Tax Court held to be zero, and such unadjusted basis cannot be reduced to a minus quantity by the deduction of depreciation.

As previously stated, Section 113(a)(5) provided that in the case of property transmitted at death the basis should be "the fair market value of such property at the time of such acquisition". *Prima facie*, this means the value as determined in federal estate tax proceedings. Reg. 111, Sec. 29.113(a)(5)-1(c).

I. R. C. Sec. 802(a) provides that for the purpose of the estate tax, the value of the gross estate of the decedent shall be determined by including the value at the time of his death of all property, real or personal, "to the extent of the interest therein of the decedent at the time of his death".

That this means, in the case of mortgaged property, the decedent's equity is established by the regulations and long settled Treasury practice.

In Reg. 105, Sec. 81.38, it is provided as follows:

> "If decedent's estate is liable for the amount of the mortgage or indebtedness, the full value of the property subject to the mortgage or indebtedness must be included as part of the value of the gross estate; the amount of the mortgage or indebtedness being in such case allowed as a deduction. But if decedent's estate is not so liable, only the value of

> the equity of redemption (or value of the property, less the indebtedness) need be returned as part of the value of the gross estate."

In the instructions for Schedule A "Gross Estate—Real Estate" of the current Estate Tax Return, Form 706, after providing that if the decendent's estate is liable for the mortgage debt the amount of such liability must be included as a deduction in Schedule L, the instructions continue as follows:

> "If, however, the decedent's estate is not liable for the amount of the mortgage, only the value of the equity of redemption (or value of the property less the indebtedness) need be extended in the value column as part of the gross estate, in which case no deduction for the indebtedness is allowable under Schedule L."

Likewise, under the Estate Tax Return, Form 706, revised September, 1931, which was filed by Mr. Crane's executrix, a mortgage on which the decedent was personally liable was required to be included under Schedule I "Debts of Decedent", while a mortgage for which the decedent was not personally liable was required to be listed under Schedule J "Mortgages, Individual Losses and Support of Dependents".

Similarly in the case of the gift tax under I. R. C. Sec. 1000, which imposes a tax on the "transfer * * * of property by gift," never to our knowledge has the Commissioner attempted to impose a tax upon a gift of mortgaged real estate without deducting the amount of the mortgage. This is true, notwithstanding Sec. 1005 which provides: "If the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift".

In order to see what was meant by "property" under these two taxes and how it is to be valued, we shall compare the applicable regulations.

Gift Tax Reg. 108, Sec. 86.19

"The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell. The value of a particular kind of property is not to be determined by a forced sale price. Such value is to be determined by ascertaining as a basis the fair market value at the time of the gift of each unit of the property. For example, in the case of shares of stock or bonds, such unit of property is a share or a bond. All relevant facts and elements of value as of the time of the gift should be considered."

Estate Tax Reg. 105, Sec. 81.10

"The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell. The fair market value of a particular kind of property includible in the gross estate is not to be determined by a forced sale price. Such value is to be determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of the property. For example, in the case of shares of stock or bonds, such unit of property is a share or a bond. All relevant facts and elements of value as of the applicable valuation date should be considered in every case."

It is self-evident that in the case of both taxes, mortgaged real estate must be valued upon the identical basis and in the identical manner. The "property" which is to be valued cannot be the equity under one section and the unencumbered real estate under the other. The parallel between the two sections is too striking.

Again in computing the deduction from gross estate for property previously taxed, the amount of the mortgage or other lien is deducted. (I. R. C. Sec. 812(c); *Ransbottom* v. *Commissioner*, 148 F. 2d. 280).

See also the case of the stamp taxes on conveyances where the amount of a mortgage to which the property is subject is excluded in determining the amount of revenue stamps to be affixed to the deed (I. R. C. Sec. 3482).

These three tax statutes, dealing as they do with taxable transfers and one of them expressly incorporated in the computation of gain or loss for the purpose of income tax, are of the highest importance. All alike adopt the theory of the Tax Court that, in the case of mortgaged real estate, only the equity is transferred by the owner or received by the transferee, and that the mortgage lien is deducted in determining the fair market value of the property transferred or the consideration for the conveyance.

The only possible reason for using estate tax valuations, as the basis for gain or loss in the case of property acquired under a will or by intestacy, is because the "property" sold, is the same "property" received from the decedent.

It ought to be self-evident that the interest of the devisee cannot possibly be any greater than that of the decedent, and that, if the decedent owned and devised encumbered real estate, the devisee could not possibly receive the real estate free and clear.

In holding that the value of the property which Mrs. Crane received from her husband was $262,048.50, although the Commissioner in estate tax proceedings held it to be zero, the Circuit Court of Appeals has used the word "property" as it appears in Section 113(a)(5) in a different sense from that used in the estate tax provisions describing what is transmitted by a decedent at death, thereby destroying the correlation between those two divisions of the Revenue Act which Congress was careful to establish.

Undoubtedly real estate is "property". But a bond and mortgage secured by real estate is also "property", *DeGanay* v. *Lederer*, 250 U. S. 376, 381, and the "fair

market value" of that "property" in the hands of the Bowery Savings Bank was at least $255,000.

Obviously Mrs. Crane did not and could not sell the Bowery's "property" consisting of the mortgage lien valued at $255,000 or more. All she could sell was what she owned, which was the encumbered real estate worth only $2,500 after expenses. To hold that, although the Bowery's mortgage was not disturbed, Mrs. Crane received $257,500, is to create a duplication of values incredible even in this inflationary age.

Judge Hand was impressed with the formalities of real estate conveyancing. He said (R. 55):

> "But the lien of a mortgage does not make the mortgagee a co-tenant; the mortgagor is the owner for all purposes; indeed that is why the 'gage' is 'mort', as distinguished from a 'vivum vadium'. *Kortright* v. *Cady*, 21 N. Y. 343, 344. He has all the income from the property; he manages it; he may sell it; any increase in its value goes to him; any decrease falls on him, until the value goes below the amount of the lien. * * *"

It is extraordinary that *Kortright* v. *Cady* was cited. By the very definition in that case upon which Circuit Judge Hand relied, the mortgage covering No. 395 Clinton Street was *vivum vadium*, because under the agreement with Mrs. Crane the Bowery Savings Bank received the net rents and applied them to the liquidation of the debt and was, for all intents and purposes, a mortgagee in possession.

Common law considerations, however, have nothing to do with the case at bar. The rule relied upon by Circuit Judge Hand was the common law rule and, as was pointed out in *Kortright* v. *Cady*, *supra*, at page 347:

> "In this State, the law is well settled that a mortgage is a mere security or pledge of the land covered

> but it for the money borrowed or owing, and referred to in it, and that the mortgagor remains the owner of the estate mortgaged, and may maintain trespass as against even the mortgagee. The debt, in the eye of the law, thus becomes the principal, and the landed security merely appurtenant and secondary; and the rights of the parties must be governed by those principles of law applicable to analogous cases."

We see no reason why "these unwitty diversities of the law of property derive from medieval concepts as to the necessity of a continuous seizin" (*Helvering* v. *Hallock*, 309 U. S. 106, 118) should govern the disposition of this case.

The realities of the situation compel the conclusion that at the date of Mr. Crane's death the lien of the mortgage was equal to the value of the real estate and that the fair market value of the property which Mrs. Crane received was exactly zero.

As we view it, the point which really disturbed the Second Circuit was the following conclusion of the Tax Court (R. 43):

> "In view of this holding, it is unnecessary to decide or consider the question of whether or not depreciation on the property for prior years was properly allowed or allowable in those years; but since depreciation in the amount of $3,200 was allowed for the taxable year 1938, and that year is before us, we hold that such depreciation was improperly allowed for the reason that there is no basis upon which to compute depreciation—the unadjusted basis being zero."

It so happened that the correctness of this holding was not involved in the appeal to the Circuit Court of Appeals. The disallowance of depreciation claimed in Mrs. Crane's

1938 income tax return was one of the elements which resulted in the deficiency of $27.77. If Mrs. Crane had desired to question the correctness of this holding, she could have raised the point by appeal or cross-appeal from the imposition of the $27.77 deficiency. Since no such appeal was taken the question was not before the Circuit Court of Appeals.

For this reason it was and is the law of the case that depreciation was improperly allowed to Mrs. Crane for 1938, because there was no cost, value or other basis upon which to compute depreciation. In effect, the real estate was fully depreciated. The Circuit Court of Appeals had no right to reopen the point which was not before it on the Commissioner's appeal. Similarly since the deduction of depreciation in 1938 which the Tax Court disallowed was no different from the deduction by Mrs. Crane in the prior years which were barred by the statute of limitations, it was and is the law of the case that depreciation was improperly claimed by Mrs. Crane for those years as well.

The law of the case, unappealed from, being that Mrs. Crane was not entitled to deduct depreciation during the years that she owned the property, the attempt by the Commissioner and by the Circuit Court of Appeals to require Mrs. Crane to pay a tax which includes the amount of such depreciation improperly deducted, was entirely out of place. *Tait* v. *Western Maryland Railway Co.*, 289 U. S. 620.

Nevertheless, we do not wish to evade arguing the point. We think that the Tax Court was correct.

It is well settled that the amount deducted annually as "depreciation" does not represent the extent of the physical loss suffered by the property through deterioration, obsolescence and similar causes, but is governed entirely by the amount which the particular owner happened to

pay for the property. *United States* v. *Ludey*, 274 U. S. 295, 301. Take for example, two similar houses built at the same time at identical cost. Suppose some years later they happen to be acquired by different individuals, one of whom paid $50,000 while the other paid $100,000. The physical loss sustained by each building would be the same, but by accounting practice and by tax law the amount of annual depreciation allowable to the second purchaser would be double that allowed to the first.

As this Court said in *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, at page 102:

> "But we think the statutory provision that the 'basis of property shall be the cost of such property' (§113(a)) normally means, and that in this case the Commissioner was justified in applying it to mean, cost to the taxpayer. A property may have a cost history quite different from its cost to the taxpayer. • • • But generally and in this case the Commissioner was in no error in ruling that the taxpayer's outlay is the measure of his recoupment through depreciation accruals."

Nothing can be clearer than the fact that Mrs. Crane's "cost" or "outlay" was zero. She paid nothing. The value of what she received was zero. There was nothing to recoup through depreciation accruals. Consequently the Second Circuit was entirely mistaken in rewriting the formula for determining gain or loss so as to permit the insertion of a deduction for depreciation predicated upon the physical wear and tear and obsolescence suffered by the buildings, instead of the cost thereof to Mrs. Crane.

Circuit Judge Hand made yet another point. He said (R. 55):

> "• • • unless the 'adjusted value' of the buildings is not computed upon the same value in finding

> the subtrahend in the equation of gain, the taxpayer gets a double deduction. By hypothesis he will have been allowed deductions seriatim, based upon the actual value of the buildings; and he will in addition have got a reduction in his gain to the extent to which actual 'wear and tear' has reduced the selling price. Manifest justice demands that he must surrender one or the other, and the only question is whether the language of the statute forbids that result."

The Court overlooked the language of the statute. It does not say that the title holder *must* be allowed to deduct depreciation from annual income, nor does it specify how the amount of allowable depreciation shall be computed.

It permits deduction of—

> "A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) (1) of property used in the trade or business, or (2) of property held for the production of income." I. R. C. Sec. 23(1).

This must mean that the person entitled to deduct depreciation is the one who suffers the loss through the occurrence of physical wear and tear or obsolescence. Ordinarily this is the title holder but it is not always so.

In *Detroit Edison Co.* v. *Commissioner, supra,* this Court denied to the titleholder a deduction for depreciation of facilities paid for by its customers. Conversely in *Helvering* v. *Lazarus & Co.*, 308 U. S. 252, where title was held by a bank in trust for certificate holders and the taxpayer had the use of the building under a long term lease from the trustee with an option to purchase, the tenant was permitted the deduction.

This Court said, at page 254:

> "While it may more often be that he who is both owner and user bears the burden of wear and exhaustion of business property in the nature of capital, one who is not the owner may nevertheless bear the burden of exhaustion of capital investment. Where it has been shown that a lessee using property in a trade or business must incur the loss resulting from depreciation of capital he has invested, the lessee has been held entitled to the statutory deduction."

See also:

Duffy v. *Central Railroad Co.*, 268 U. S. 55;
Cogar v. *Commissioner*, 44 F. 2d. 554;
Reisinger v. *Commissioner*, 144 F. 2d. 475;
Helvering v. *Terminal Railroad Ass'n*, 89 F. 2d. 739;
Bonwit Teller, Inc. v. *Commissioner*, 136 F. 2d. 978; Cert. denied 320 U. S. 794;
Georgia Railway & Electric Co. v. *Commissioner*, 77 F. 2d. 897, cert. denied 296 U. S. 601.

See also I. R. C. Sec. 23(e)2, which in certain cases permits a life tenant of depreciable property to take depreciation, but denies it to the title holder.

If we stop to consider who it was that suffered the loss through wear and tear in the present case, it is self-evident that the Bowery Savings Bank was the sufferer. Circuit Judge Hand himself suggested that when he pointed out that no decrease in value falls on the owner "until the value goes below the amount of the lien" (R. 55).

The Bowery Savings Bank which held the mortgage was the party affected by depreciation. With the lapse of time the value of the mortgaged premises became less and less.

If the Bowery Savings Bank had foreclosed the mortgage and been successful in selling the mortgaged premises at cost less depreciation, it would have sustained a loss equivalent to the accumulated depreciation which it could have used as a deduction in its federal income tax return.

Gardner Printing Co. v. *Commissioner*, 4 B. T. A. 37;
Even Realty Co. v. *Commissioner*, 1 B. T. A. 355.

Although the Second Circuit talked about double deductions, its ruling would open the door wide to such practice.

Many title holders of mortgaged real estate with little or no equity have ultimately lost their property through foreclosure or a deed in lieu of foreclosure without consideration. The Second Circuit would permit such title holders to take annual deductions for depreciation, although they had nothing to lose, and would not charge them with a gain when they lost their property. But the mortgagee, when it resold the property at a price which would presumably reflect the wear and tear suffered, would be permitted a loss represented by the difference between the amount of the mortgage loan and the amount realized.

This is a very frequent occurrence. Yet both the title holder and the mortgagee would be permitted to get the benefit of a deduction for the same physical depreciation.

The double deduction in Mrs. Crane's case, if it exists at all, was due only to the error of Mrs. Crane in claiming depreciation which she was not entitled to and the error of the Commissioner in failing to disallow it. The evidence showed that the actual amount of tax loss to the Treasury was between $150 and $200. Mrs. Crane is permitted to retain this unwarranted benefit, solely by reason of the statute of limitations which prevents the Commissioner from reopening her returns.

There is nothing extraordinary about this. The statute of limitations represents a public policy which sometimes works in favor of the taxpayer protecting him in an underpayment of tax, and sometimes in favor of the Treasury permitting the retention of an unjust over-collection. Assuredly, the operation of the statute in Mrs. Crane's favor to the extent of $150 to $200 of tax does not justify the effort to collect from her in another way a tax more than ten times as great.

There is another fallacy in the opinion of the Circuit Court of Appeals. Recognizing that a conveyance of mortgaged real estate is a sale, whether brought about by foreclosure or by deed to the mortgagee in lieu of foreclosure (*Helvering* v. *Hammel*, 311 U. S. 504), Judge Hand sought some theory by which a gains tax on such a transaction might be avoided. The solution which he advanced was to treat the transfer as an "abandonment" to the mortgage. He warned that "a slight sum of money will make the transaction a sale" and added that "escape is open to the mortgagor as soon as he decides to treat the venture as at an end" (R. 56).

Suppose the mortgagee refuses to accept a deed,—what then? The mortgagee frequently refuses to accept a deed and insists on foreclosure, either where there are encumbrances junior to his mortgage which he desires to eliminate, or where the owner has a bad record or is financially irresponsible, or where the mortgagee does not wish to run the risk of having an unmarketable title which he might have difficulty in selling. Indeed, the petition in this case alleged that Mrs. Crane tendered a deed to the Bowery which refused to accept it (R. 18). Certainly no "escape" was open to Mrs. Crane under Judge Hand's theory.

In actual practice where the mortgagee is willing to accept a deed in lieu of foreclosure, the owner almost invari-

ably receives a cash consideration of from $100 to $500, *i. e.*, slightly less than foreclosure costs. Even where no cash is involved, the mortgagee at least is generous enough to pay and thereby relieve the owner of paying the cost of conveyancing. We should suppose that that was "a slight sum of money", or property, which would subject the owner to a huge gains tax under Judge Hand's theory. But apparently this is not the case.

Undoubtedly, the owner can "terminate the venture" by conveying the real estate to a dummy whom he may have to pay for the accommodation. This is just as effective an abandonment as a conveyance to the mortgagee, but Judge Hand would hold the transaction taxable.

As we remarked (Brief, p. 34), there is no substance in these distinctions. Why should Mrs. Crane have a gain of some $20,000 if she conveyed the property without consideration to John Doe but none if she conveyed it to the Bowery Savings Bank? Why should she have a gain of $23,767.03 when she conveyed it to Avenue C Realty Corp. for $2,500 "in order to avoid foreclosure", but no gain if she "abandoned" it to the Bowery for $2,500? Why is the mortgage "property received" in one case and not in the other?

These tangled results of the Second Circuit's holding are due solely to its effort to escape from an artificial situation of its own creation, which it recognized as illogical, unjust and intolerable.

Under the decision of the Tax Court, the owner is only taxed on what he actually received. When the equity of the owner was wiped out, no further annual deduction for depreciation was permissible, because the owner suffered no loss, the actual loss being that of the mortgagee. Consequently, when he lost the property there would be no depre-

ciation which could be used to "adjust" the basis and create a fictitious "gain".

Remedial measures in cases of improper deduction for depreciation lie in permitting returns for statute-barred years to be reopened for the disallowance of depreciation deductions, rather than the creation of an imaginary "amount realized", a fictitious "basis", a mythical "gain", and the imposition of tax dependent upon the presence or absence of a few pennies or dollars of consideration and the identity of the transferee.

Therefore, we regard as completely unsound and fallacious the Commissioner's terror-stricken argument that, if the Tax Court in this case should be sustained, devisees of real estate subject to a mortgage will be deprived of depreciation allowances based upon the fair market value of the buildings, or that the allowance for depreciation will change every time the devisee amortizes part of the mortgage, or that there would be a "minus basis" for the devisee when the mortgage exceeds the fair market value of the property at the date of the decedent's death.

A minus basis is a mathematical and legal absurdity as the Tax Court pointed out (R. 43), *Woolford Realty Co.* v. *Ross*, 286 U. S. 319, 327. There is not the slightest danger that any of these consequences will ensue, so long as the Commissioner follows the language which Congress laid down, limiting the allowance for depreciation to the taxpayer's cost and denying such allowance to taxpayers who suffer no loss through physical wear and tear.

We respectfully submit that Mrs. Crane's gain could not and did not exceed the sum of $2,500, the net consideration which she received for her interest in the apartment house, and that the Tax Court was correct in so holding.

POINT IV.

Mrs. Crane received no income within the meaning of the 16th Amendment except the sum of $2,500 on which she paid an income tax. The determination of the Second Circuit that she received income of $24,031.45, if required by the Revenue Act, violated Article I of the Constitution and the 5th Amendment thereto.

The shocking injustice of imposing an "income" tax of $1,932.99 upon a fictitious "gain" of $24,031.45, when in fact Mrs. Crane only received the sum of $2,500, compels consideration of the constitutional safeguards enjoyed by American citizens against arbitrary impositions of this character.

It is well settled that the 16th Amendment did not enlarge the field of taxation open to Congress under Article I, Section 8 of the Constitution, but simply removed in the case of a tax on income the restrictions as to uniformity and apportionment imposed upon the taxing power of Congress by Section 9 of that Article.

We may concede that the power of Congress to tax its citizens has few, if any, limits. We may even grant, at least for the purpose of this argument, that Congress has power under the Constitution to make a capital levy for the support of the Government.

But in such case, as in the case of every tax under Article I of the Constitution, except only an income tax as to which special provision is made in Amendment 16, the requirements as to uniformity and apportionment among the several States must be observed. *Pollock* v. *Farmers Loan & Trust Co.*, 158 U. S. 601.

Therefore, if the Revenue Act of 1938 should be so construed as to characterize as "income" a fictitious figure

which is not, in fact, income, derived by the use of mathematical imaginaries, a tax on such "income" cannot claim the protection of the 16th Amendment, and must fall because the requirements of Article I were not followed. *Eisner* v. *Macomber*, 252 U. S. 189.

Applying these firmly established principles to the case at bar, a construction of the Revenue Act of 1938 which would attribute to Mrs. Crane a "gain" or "income" in excess of $2,500, could not meet the test of constitutionality. *Bowers* v. *Kerbaugh-Empire Co.*, 271 U. S. 170; *Edwards* v. *Cuba Railroad Company*, 268 U. S. 628; *Nicholas* v. *Fifteenth Street Investment Company*, 105 F.2d. 289.

The meaning of the word "income" in the 16th Amendment is the same as when used in common speech. *Eisner* v. *Macomber*, *supra*, at p. 207; *Sprouse* v. *Commissioner*, 122 F. 2d. 973, aff'd. 318 U. S. 604.

The action of a majority of the Second Circuit in the case at bar in transforming into a highly profitable transaction, an event which, in the ordinary meaning of language and by all dictates of common sense, was a ruinous disaster, emphasizes anew the need of the individual citizen for those safeguards against arbitrary governmental action as established by the Bill of Rights and contained in the limitations of the Constitution.

When Mrs. Crane is singled out and told that her gain was $24,031.45 which she did not receive, instead of $2,500 which she did receive, if the statute justified the Court's decision, the need for constitutional protection is clear. If Mrs. Crane is treated thus, why should not her fictitious "income" be $240,314.50 or $2,403,145? Or any sum of money which approves itself to the Commissioner's fancy?

We respectfully submit that the alleged gain of $24,031.94 was not "income" within the meaning of the

16th Amendment, as laid down in the decisions of this Court cited under this point heading. The levying of a tax thereon was not an income tax within the purview of the 16th Amendment, but was, in fact, a capital levy made without apportionment and without regard to any census or enumeration and consequently violated Article I, Section 9, and the 5th Amendment to the Federal Constitution.

POINT V.

The judgment of the Circuit Court of Appeals should be reversed and the judgment of the Tax Court of the United States should be affirmed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1946.

No. 68.

BEULAH B. CRANE,

Petitioner,

against

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITIONER'S REPLY BRIEF.

EDWARD S. BENTLEY,
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PETITIONER'S REPLY BRIEF.

The Commissioner does not, and cannot deny that the limiting factor of the statutory formula is that a taxpayer's gain cannot exceed the amount realized from the sale.

Although the language of Section 111(b) was and is explicit and unmistakable, viz., that "the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received," the Commissioner seeks to attach to it by statutory construction, or insert in it through Treasury practice, the proviso that the amount of the mortgage held by the Bowery Savings Bank was "property (other than money) received" by Mrs. Crane, notwithstanding the conceded fact that Mrs. Crane did not own the mortgage, was not liable upon it, and received no benefit when the real estate was sold beyond the cash received.

Abandoning the argument repeatedly urged by the Commissioner in other cases and announced by this Court that, in the matter of taxation, realities and not legal niceties must control, the Commissioner here seeks to impose a tax not on what Mrs. Crane received but upon what she did not receive.

In so doing, the Commissioner seeks to extend the principle of *U. S.* v. *Hendler*, 303 U. S. 564 that assumption of taxpayer's indebtedness was property received by the taxpayer, into a holding that the non-assumption of an indebtedness of someone other than the taxpayer was likewise property received by the taxpayer.

Recognizing that, of itself, Sec. 111(b) is not susceptible of the construction urged, the Commissioner's argument takes the inductive form, commencing with the premise that the word "property" as used in the estate tax, disregards the mortgage encumbrance.

Right here the fallacy begins. Rejecting those meanings of the word "property" which include the element of value or the extent of the owner's interest, the Commissioner selects the definition which describes merely the technical character of the legal title acquired, e.g., title in fee simple absolute. That, he says, is the basis, not the value of the decedent's interest or the value of the property, i.e., the equity received by the devisee.

But under the estate tax law, neither the gross estate nor the tax imposed by the Revenue Act depends upon the character of the decedent's title. Instead it is imposed upon the value of the decedent's interest, i.e., his equity. It makes no difference in tax whether the full value of the real estate is listed in one schedule and the amount of the mortgage deducted in another, or whether only the equity is shown. The result is the same in either case.

When the Commissioner predicates his argument upon a distinction between the character of the title which passed upon Mr. Crane's death and the value of the interest passing, he ignores the basic concept upon which the estate tax, the gift tax, and the stamp tax on transfers depend, viz., the value of the interest owned or transferred. There is nothing in the estate tax or the gains tax, or in justice or common sense, which permits the Commissioner to use as his basis the title which was transmitted at death and to ignore entirely the element of value attributable to the decedent's interest.

The gains tax itself is based upon a very different theory from that argued by the Commissioner. As the statute expressly states, in the ordinary case it is the difference between the amount realized for the article and the taxpayer's cost. In the case of inherited property where the taxpayer paid nothing, or in the case of property acquired prior to the effective date of the Revenue Act or applicable amendment, value is used as the basis because it approximates as closely as possible the cost basis used in the normal case.

Title has nothing to do with it. Title might be in fee simple absolute, or by the entireties, or a conditional fee, or any of the innumerable common law or statutory creations which delight the legal theorist. Title may be good, bad or indifferent, or indeed the taxpayer might have no title at all. Yet in the case of inherited property, according to the Commissioner, the basis is not the cost or value of the interest acquired and subsequently sold by the taxpayer, but the value of the legal title free from encumbrances, making a difference in the present case of over $255,000.

The gains tax is a very practical one. It is obvious that a seller can only realize money or property other than money, for the interest which he has for sale. He cannot

(lawfully at least) realize anything for an interest which he does not own, cannot convey, does not purport to sell, and from which he receives no benefit. By express command of the statute, the tax is imposed upon a realized gain, not on a theoretical or imaginary one.

This must be so in order to conform with constitutional requirements. Under the 16th Amendment, an income tax cannot be imposed upon an interest which the taxpayer never owned, never received, and of which he never had or could have the benefit.

Ignoring both the constitutional obstacle and the Tax Court's finding (R. 41, 42) upon the stipulated evidence (R. 29) that only the equity was sold by Mrs. Crane, the Commissioner argues thus:—The basis is the value of the real estate without regard to the mortgage; therefore, the amount realized cannot be simply the cash received for the equity, but must have included the amount of the mortgage.

With equal right and with far greater reason and common sense, we may reverse the argument thus:—The amount realized under Sec. 111(b) is the amount realized without including the undisturbed mortgage; therefore, the basis must be the equity and cannot include the amount of the mortgage encumbrance.

However, it is unnecessary for us to go beyond the amount realized. Since in the present case only the equity was sold (indeed since Mrs. Crane was virtually an owner out of possession all she could sell was the equity), and only $2,500 net was received, it is unnecessary to argue about the base. We conceded as the base the lowest possible arithmetical figure,—zero.

The Commissioner makes a great point of the fact that Mrs. Crane deducted depreciation, which the evidence showed gave her a petty tax advantage of some $150 or $200.

The issues involved in this case, however, do not depend upon the question of depreciation. The same issues would be presented even if the real estate had been unimproved and had not been susceptible of depreciation at all.

Thus upon Mr. Crane's death the real estate was appraised at $262,042.50 and was subject to a mortgage encumbrance of $262,042.50. (The executor claimed a lower valuation in the return, but the Revenue Agent raised it.) When Mrs. Crane sold her equity for $2,500, the mortgage lien had increased to $270,857.71, an increase of exactly $8,815.21. Under the Commissioner's argument, Mrs. Crane's taxable gain would have been $8,815.21 plus the cash of $2,500, even if the property had been unimproved and there had been no depreciation whatsoever. It is true that in our case the Revenue Agent disregarded the increase which had occurred in the mortgage lien; but the Commissioner's line of reasoning permits of no distinction as to the nature or source of the mortgage lien, and it would be entirely immaterial how much of the mortgage lien was attributable to principal and how much to interest, since the mortgage secures both principal and interest. Under the Commissioner's argument the mortgage lien is disregarded for the purpose of determining the basis, and included in computing the amount realized, thereby actually taxing the owner not only upon the amount of the mortgage which he did not receive, but also upon the interest upon that mortgage which he was unable to pay.

Another example is appropriate. Suppose that the real estate was unimproved and at the date of death the amount of the mortgage exceeded the value of the real estate. According to the Commissioner's theory, if the devisee later sold his equity for a dollar, he would have a taxable gain equal to the difference between the value of the real estate

at the date of death and the amount of the mortgage at the time of sale plus one dollar in cash. Does the Commissioner seriously contend that the devisee would realize a taxable gain in a case like this?

We give little weight to many Treasury regulations cited by the Commissioner. The Commissioner admits that none of them are in point. Whatever they say, they cannot run counter to Sec. 111(b) which defines the amount realized as the money received plus the fair market value of property other than money received. No matter what the regulations may provide, they cannot treat as property received by the taxpayer, the mortgage debt owned by the Bowery Savings Bank, which was never received by the taxpayer at all.

Nevertheless, it is noteworthy that the only regulation considering mortgages as property received is limited to the special case of installment sales. Instead of indicating, as the Commissioner argues, that ordinary non-installments are governed by the same rule, it seems to us that the maxim *expressio unius est exclusio alterius* is fully applicable, and that this regulation raises the inference that mortgages are to be included as amount realized only in the case of installment sales, and that in the case of sales such as the one in the case at bar, mortgages on which the taxpayer is not liable are to be treated otherwise.

That this is true, is shown by I. R. C. Sec. 44, which places installment sales in a special category and lays down special provisions applicable to such sales.

As for 1944 P-H par. 60512, and 1944 C. C. H. pars. 8843-8850, it should be noted that the discussion and criticism of the opinion of the Tax Court is predicated upon the erroneous assumption that Mrs. Crane was personally liable for the mortgage debt and that, therefore, she received a re-

lease of personal liability or equivalent benefit upon the sale.

See, however, the thoughtful and carefully reasoned discussion of the case in Chicago Law Review, Vol. 13, p. 510 (June 1946) which approves the Tax Court and disapproves the Circuit Court of Appeals decision.

It is submitted that the Commissioner's argument is fallacious and unsound, and that, for the reasons pointed out in our main brief, the judgment of the Circuit Court of Appeals, Second Circuit, should be reversed and the determination of the Tax Court should be affirmed.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1945

BEULAH B. CRANE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 994

BEULAH B. CRANE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 22–32) is reported in 3 T. C. 585. The opinion of the Circuit Court of Appeals (R. 33–37) is reported in 153 F. 2d 504.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 28, 1945. (R. 38.) The petition for a writ of certiorari was filed on March 25, 1946. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer received under her husband's will an apartment house, worth about $262,000 at the time of his death and subject to a mortgage of $255,000 and accrued interest of about $7,000, so that her equity in the property was zero. For seven years she was allowed deductions for depreciation on the full value of the building without any reduction on account of the mortgage. At the end of that period the taxpayer sold the property, subject to the mortgage, for a net sum of $2,500. The question presented is the amount of taxpayer's gain, which depends upon (1) the correct cost basis of the property within the meaning of Section 113 (a) (5) of the Revenue Act of 1938 and the applicable Treasury Regulations, and (2) the amount realized upon the sale within the meaning of Section 111 (a) and (b).

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved may be found in the Appendix, *infra*, pp. 16–19.

STATEMENT

The parties filed a stipulation of facts which was adopted by the Tax Court as part of its findings of fact. The stipulated facts not set forth in the Tax Court's findings were expressly included by reference. The findings of the Tax Court (R. 23–26) may be summarized as follows:

The taxpayer was the sole legatee and devisee of her husband, who died on January 11, 1932, and was also the executrix of his estate. The decedent owned an apartment house, which at the time of his death was subject to a mortgage in the amount of $255,000, and on which there was due accrued interest in the amount of $7,042.50, so that the total lien on the property was $262,042.50.[1] For the purpose of the federal estate tax, the property was appraised as of the date of decedent's death at a value of $262,042.50, the exact amount due on the mortgage. (R. 23.)

On February 1, 1932, and at all times thereafter until the property was sold in November, 1938, the mortgage was in default for the nonpayment of interest. (R. 23.) In the early part of 1932 the taxpayer and the mortgagee entered into an agreement whereby the taxpayer was to operate the apartment house property, collect the rents, and pay for all necessary repairs and other expenses, reserve $200 a month for the payment of taxes, and remit the balance to the mortgagee at the end of each month on account of the mortgage. (R. 23–24.) The *net* rentals from the premises for the years 1932 to 1938, inclusive, were paid to the mortgagee by the taxpayer in accordance with the agreement. (R. 24.)

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[1] The record does not show whether the decedent personally assumed liability on the mortgage, or acquired the property subject to the mortgage.

In 1938 when the mortgagee was about to foreclose the mortgage, the taxpayer, in order to avoid such action, entered into a contract to sell the property *subject to the mortgage* for a cash consideration of $3,000. Pursuant to the contract, the taxpayer conveyed the property on November 29, 1938, and received $3,000 in cash, out of which she paid expenses in the amount of $500. The taxpayer was not a party to the mortgage, and did not at any time assume any personal liability upon the mortgage. (R. 24.)

Taxpayer filed income tax returns for the estate and for herself for the years between the death of decedent and the sale of the property, in which she reported the rentals from the apartment house as gross income, and claimed deductions for interest paid on the mortgage and for the taxes and operating expenses of the property. (R. 24–25.) She claimed deductions for depreciation each year, ranging from $3,200 to $3,900, and aggregating $25,500. (R. 2[illegible])

In her return for 1938, the taxpayer reported a capital gain of $2,500 from the sale of the apartment house property, and included one-half, or $1,250, in her income. The Commissioner determined that the taxpayer sustained a capital loss of about $500 from the sale of the land, and that she realized an ordinary gain of about $24,000 from the sale of the building. (R. 25.) The taxpayer sought a review of the Commissioner's determination in the Tax Court, which decided that

the basis of the property was zero and that the gain was limited to $2,500, which represented the total "amount realized." The Commissioner appealed to the Circuit Court of Appeals, which reversed the decision of the Tax Court, with Judge Swan dissenting.

ARGUMENT

1. This is the first case in which the precise question involved has arisen, and there is therefore no possibility of a conflict of decisions. Moreover, the decision of the court below is correct and is in harmony with the uniform practice of long standing of the Treasury Department.

The principal question is the amount of gain realized by the taxpayer on the sale of property acquired by bequest subject to a mortgage and sold by the taxpayer subject to the mortgage. In order to determine the amount of gain realized on the sale of the property in question, it is necessary first to determine the cost basis of the property within the meaning of Section 113 (a) (5) of the Revenue Act of 1938 (Appendix, *infra*) and the applicable Treasury Regulations, and secondly, the amount realized from the sale of the property within the meaning of Section 111 (a) and (b) of the Revenue Act of 1938 (Appendix, *infra*).

Section 113 (a) (5) provides in part that the basis of property acquired by bequest, devise or inheritance shall be the fair market value of such property at the time of such acquisition. Article

113 (a) (5)–1 of Treasury Regulations 101 (Appendix, *infra*) provides in subdivision (b) (1) that the time of the acquisition of such property is the death of the decedent, and in subdivision (c), that for the purposes of this article, the value of the property as of the date of the death of the decedent as appraised for the purpose of the federal estate tax shall be deemed to be its fair market value at the time of the death of the decedent. This provision of the Treasury Regulations has been in effect since 1918,[2] and the corresponding statutory provision has been reenacted in substantially the same form in all succeeding Revenue Acts.[3] There can be no doubt that for estate tax purposes Congress intended that the reported value of the

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[2] See Treasury Regulations 45, Art. 1562; Treasury Regulations 62, Art. 1563; Treasury Regulations 65, Art. 1594; Treasury Regulations 69, Art. 1594; Treasury Regulations 74, Art. 596; Treasury Regulations 77, Art. 596; Treasury Regulations 86, Art. 113 (a) (5)–1 (c); Treasury Regulations 94, Art. 113 (a) (5)–1 (c); Treasury Regulations 101, Art. 113 (a) (5)–1 (c); Treasury Regulations 103, Sec. 19.113 (a) (5)–1 (c); Treasury Regulations 111, Sec. 29.113 (a) (5)–1 (c).

[3] Sec. 202 (a) (3) of the Revenue Act of 1921, c. 136, 42 Stat. 227; Sec. 204 (a) (5) of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sec. 204 (a) (5) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Sec. 113 (a) (5) of the Revenue Act of 1928, c. 852, 45 Stat. 791; Sec. 113 (a) (5) of the Revenue Act of 1932, c. 209, 47 Stat. 169; Sec. 113 (a) (5) of the Revenue Act of 1934, c. 277, 48 Stat. 680; Sec. 113 (a) (5) of the Revenue Act of 1936, c. 690, 49 Stat. 1648; Sec. 113 (a) (5) of the Revenue Act of 1938, c. 289, 52 Stat. 447; Sec. 113 (a) (5) of the Internal Revenue Code, as amended by Sec. 144 of the Revenue Act of 1942, c. 619, 56 Stat. 798.

property in the gross estate should not be reduced by a mortgage; the amount of the mortgage is included in the deductions employed in computing the net estate. See H. Rep. No. 708, 72d Cong., 1st Sess., p. 48 (1939–1 Cum. Bull. (Part 2) 457, 491), and S. Rep. No. 665, 72d Cong., 1st Sess., p. 51 (1939–1 Cum. Bull. (Part 2) 496, 533), explaining Section 805 of the Revenue Act of 1932, which amended Section 303 (a) of the Revenue Act of 1926.

Applying the regulation to the facts of this case, the Tax Court said (R. 29):

> There is no dispute here as to the fair market value of the apartment house property at the basic date. That value is $262,042.50, which was used for estate tax purposes.

While the precise question involved in this case relates to the amount of *gain* realized on property, subject to a mortgage, acquired by the taxpayer by bequest and sold by the taxpayer subject to the mortgage, the case necessarily involves the question of *depreciation* on property acquired by bequest and subject to a mortgage, because Section 114 of the Revenue Act of 1938 (Appendix, *infra*) provides that the basis for depreciation shall be the same as the basis for gain or

[1] However, the Tax Court erroneously substituted for this figure the value of the taxpayer's interest in the property. (R. 29.) This defeats the statutory purpose to protect the revenue by requiring the devisee to use as a basis the same value which was reported for estate tax purposes. Section 113 (a) (5) of the 1938 Act (Appendix, *infra*). Compare *Maguire* v. *Commissioner*, 313 U. S. 1, 10.

loss.[5] Indeed, in this case the taxpayer claimed, and was allowed, deductions for depreciation based on the full value of the building on the date of the death of the devisee without any deduction on account of the mortgage. The deductions aggregated $25,500, which approximates the amount of gain determined by the Commissioner. (R. 25.) Moreover, as the court below pointed out in its opinion, to treat the devisee's equity as the basis for depreciation would require repeated recomputations,[6] if the devisee pays off the mort-

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[5] It was because this case threatened the long continued policy of the Treasury Department with respect to depreciation of property acquired by bequest and subject to a mortgage that some of the federal tax services adversely criticized the opinion of the Tax Court in this case. 1944 P-H, par. 60,512; 1944 C. C. H., pars. 8843–8850, inclusive.

[6] Assume, for example, that a taxpayer inherits business property with a fair market value of $90,000, subject to an unassumed mortgage of $40,000, leaving as his equity $50,000; that he depreciates the property on a straight line basis on an estimated life of 20 years; and that he makes an annual $2,000 payment on mortgage principal. In the first year the depreciation on the equity is $2,500. For each successive year the basis will have to be adjusted to reflect the principal payments on the mortgage, and depreciation for previous years will have to be substracted from the adjusted basis to determine the amount of depreciation allowable for the next succeeding year. Thus for the second year the depreciation will be [($50,000 plus $2,000)—$2,500] divided by 19, or a result of $2,505.26; for the third year $2,716.37; and for the fourth year $2,834.02. The depreciation allowances will increase progressively as the property's estimated life decreases; the nineteenth mortgage principal payment of $2,000 will be entirely depreciated within the twentieth year; and

gage in installments and would introduce administrative complication and confusion. (R. 35.) The court below said in its opinion (R. 35):

> We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings.

Having determined the unadjusted basis of the property, it is then necessary under Section 111 (a) to determine the adjusted basis under Section 113 (b) (Appendix, *infra*), which provides for the reduction of the basis by the amount of depreciation allowed, but not less than the amount allowable. This Court decided that it was necessary to adjust the cost basis on account

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the property's estimated life will have expired before the twentieth payment of $2,000 on mortgage principal can be depreciated.

Moreover, if taxpayer fails to amortize the mortgage for a number of years and then under pressure of threatened foreclosure makes a substantial payment in one year, the consequence will be to compress a large allowance for depreciation within a relatively short period. Should the taxpayer in the above illustration make no payments on the mortgage until the sixteenth year and then reduce the mortgage by $30,000, he will be entitled, under the rule of the instant case, to depreciate the $30,000 capital outlay in the remaining five-year life of the property, together with the remaining five years' depreciation of his original equity interest.

Another result might be to set up a minus basis for the property in those cases where the amount of the mortgage exceeds the fair market value of the property on the critical date (the date of the decedent's death).

of accrued depreciation in order correctly to determine the amount of gain or loss. *United States* v. *Ludey*, 274 U. S. 295.[1] Since there is no dispute as to the value of the apartment house on the date of the devisor's death and no controversy about the rate of depreciation, namely, two percent, the adjustment on account of depreciation is a mere matter of simple computation.

As to the second factor, in determining gain or loss, the "amount realized" from the sale of property is the sum of any money received plus the fair market value of the property (other than money) received. Section 111 (b) of the Revenue Act of 1938. While the taxpayer did not assume liability on the mortgage, she held the property subject to the mortgage and was obliged to pay interest on the mortgage as long as she held the property. Unless she also paid the installments of principal as they fell due, she stood to lose the property upon foreclosure and to forfeit whatever income might be derived from it. She assumed these burdens in accepting the devise; and she recognized that fact when she made arrangements with the mortgagee to pay it the net income from the property instead of paying interest and installments of principal.

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[1] This Court has also decided that the cost basis must be adjusted on account of depreciation even though the taxpayer does not receive a tax benefit from unclaimed allowance for depreciation. *Virginian Hotel Co.* v. *Helvering*, 319 U. S. 523.

The Tax Court found that in the income tax returns for the period during which she held the property she claimed deductions for interest paid on the mortgage. This was in accordance with Treasury Regulations of long standing* which treated her as though she were directly liable on the mortgage, and as though the mortgage debt were her debt.

She was relieved of these obligations when she sold the property, subject to the mortgage, and thus the cash alone is not the full measure of the consideration she received. In the absence of any evidence to the contrary as to the value of these benefits, it would seem reasonable to value them in the amount of the principal of the mortgage, because that figure represents the capitalized value of her obligation to pay interest and the aggregate of the installments of principal.

Furthermore, it would be unreasonable to include the amount of the mortgage for the purpose of determining the *basis*, as required by the application of the regulation to the facts of this case, and then to exclude the amount of the mortgage in ascertaining the *amount realized*. In

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* See Treasury Regulations 45, Art. 121; Treasury Regulations 62, Art. 121; Treasury Regulations 65, Art. 121; Treasury Regulations 69, Art. 121; Treasury Regulations 74, Art. 141; Treasury Regulations 77, Art. 141; Treasury Regulations 86, Art. 23 (b)-1; Treasury Regulations 94, Art. 23 (b)-1; Treasury Regulations 101, Art. 23 (b)-1; Treasury Regulations 103, Sec. 19.23 (b)-1; Treasury Regulations 111, Sec. 29.23 (b)-1.

this case, such inconsistency would permit the taxpayer to show a loss of more than $175,000 on the building, when she admittedly realized some gain. Under the regulation her unadjusted basis for the entire property (land and building) was about $262,000, as shown above; and when this figure is adjusted on account of depreciation allowable during the period she held the property, the adjusted basis of the building is about $178,000. (R. 25.) If the amount of the mortgage is excluded in computing the amount realized, the taxpayer received only the cash payment of $2,500. The excess of the adjusted basis of about $178,000 over the amount realized, $2,500, would result in a loss of about $175,000.

It may be pointed out that if the principal amount of the mortgage is not included in the amount realized, it would seem to follow that the purchaser from the taxpayer has a cost basis of only $2,500 for the property, and that this is contrary to the generally prevailing accounting practice. See II Kester, Accounting Theory and Practice (2d ed., 1925) 383; also 1944 P-H, par. 60,512.

The Tax Court refused to include the amount of the mortgage in the amount realized because the taxpayer had not assumed liability on the mortgage. Ever since 1926[9] the Treasury Regulations relat-

[9] See Treasury Regulations 69, Art. 44; Treasury Regulations 74, Art. 352; Treasury Regulations 77, Art. 352; Treas-

ing to installment sales have provided that in the sale of mortgaged real estate the amount of the mortgage shall be included as a part of the selling price, *whether the property is merely taken subject to the mortgage or whether the mortgage is assumed by the purchaser.* By analogy, it should not make any material difference in this case whether the taxpayer assumed the mortgage or took the property subject to the mortgage. See also Section 213 (d) of the Revenue Act of 1939, c. 247, 53 Stat. 862, amending Section 113 (a) (6) of the Internal Revenue Code, where Congress has treated the acquisition of property subject to a liability in the same manner that it treats the assumption of a liability, for basis purposes. This policy would appear to be sound because mortgage holders of commercial property ordinarily look to the land as security and not to the financial standing of the mortgagor.

A choice must be made between two alternatives: (1) An allowance of depreciation on the full value of the property, with a consequent inclusion of the mortgage as a common element of cost and amount realized, or (2) an exclusion of the mortgage as such an element, with a consequent reduction of the depreciation allowance. Pursuant to a long standing administrative practice, the Com-

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ury Regulations 86, Art. 44-2; Treasury Regulations 94, Art. 44-2; Treasury Regulations 101, Art. 44-2; Treasury Regulations 103, Sec. 19.44-2; Treasury Regulations 111, Sec. 29.44-2.

missioner chose the first course. The Tax Court preferred the second alternative, on the theory that a distinction should be drawn between a taxpayer who is liable on a mortgage and a taxpayer who assumes a mortgage.[10] While such distinctions have been drawn under circumstances foreign to the situation disclosed here, none of the cases upon which taxpayer relies has involved the problem of the need for correlating the basis for depreciation with the computation of gain or loss upon sale. We think Congress clearly intended that the mortgage be included in the basis for depreciation and that respect for the obvious symmetry of the statutory scheme compels the conclusion that it be also included in the amount realized.

2. The taxpayer also assigns as a reason for granting the writ the contention that it would violate the Sixteenth Amendment to impose a tax on the basis of a gain of about $24,000. This argument assumes, contrary to *United States* v. *Ludey*, 274 U. S. 295, that taxpayer sold precisely the same property acquired by bequest. The truth is that the property had depreciated to the extent of more than $24,000.

3. The taxpayer alleges in her petition that the decision of the court below is in conflict with the decisions of this Court in *John Kelley*

[10] In a later opinion the Tax Court has qualified its distinction. *Hilpert* v. *Commissioner*, 4 T. C. 473, reversed, 151 F. 2d 929 (C. C. A. 5th).

Co. v. *Commissioner,* decided January 7, 1946, not yet reported, and *Dobson* v. *Commissioner,* 320 U. S. 489. The critical question in this case is whether in determining the "amount realized" upon the sale of property a distinction should properly be made between a taxpayer who is personally liable on the mortgage and one who is not, although the amount of the mortgage must be included in the basis of the property in accordance with the terms of a Treasury regulation. We submit that this presents a clear-cut question of law which is reviewable. See *Commissioner* v. *Wilcox,* decided by this Court on February 25, 1946, not yet reported.

CONCLUSION

There is no conflict of decisions and the decision of the court below is correct. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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SEWALL KEY,
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APRIL, 1946.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of Gain or Loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount Realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

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SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * * * *

(b) *Adjusted Basis.*—The adjusted basis for determining the gain or loss from the

sale or other disposition of property, whenever acquired, shall be the basis determined under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws, * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * *

Treasury Regulations 101, relating to the Revenue Act of 1938:

ART. 113 (a) (5)–1. *Basis of property acquired by bequest, devise, or inheritance.*—* * *

(b) * * *

(1) *General rule.*—Except as prescribed in paragraph (2) the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since under the law governing wills

and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. * * *

The purpose of the Act, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

* * * * *

(c) *Fair market value.*—For the purposes of this article, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or if the property is not appraised as of the date of death of the de-

cedent for such purpose or if the estate is not subject to such tax, its value as appraised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of the death of the decedent.

* * * * *

(e) *Adjustments to basis.*—In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or inheritance, the basis of the property is always the same,

(1) whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a trust created by the will, or any beneficiary of such trust, and whatever the nature of any such person's interest or estate may be;

(2) whether during or after administration and settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

Adjustments to basis required by section 113 (b) are made in accordance with the same principles. * * *

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U. S. GOVERNMENT PRINTING OFFICE: 1946

No. 68

In the Supreme Court of the United States

OCTOBER TERM, 1946

BEULAH B. CRANE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT

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In the Supreme Court of the United States

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No. 68

BEULAH B. CRANE, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court of the United States (R. 34–45) is reported in 3 T. C. 585. The opinion of the Circuit Court of Appeals (R. 53–56) is reported in 153 F. 2d 504.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on December 28, 1945. (R. 57.) The petition for a writ of certiorari was filed on March 25, 1946, and granted on April 29, 1946. (R. 57–58.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer received under her husband's will an apartment house, worth about $262,000 at the time of his death and subject to a mortgage of $255,000 and accrued interest of about $7,000, so that her equity in the property was zero. For seven years she collected the rents, paid the operating expenses, interest on the mortgage, and taxes, and was allowed deductions for depreciation on the full value of the building without any reduction on account of the mortgage. At the end of that period the taxpayer sold the property, subject to the mortgage, for a net sum of $2,500.

The question presented is the amount of taxpayer's gain, which depends upon (1) the unadjusted basis of the property within the meaning of Section 113 (a) (5) of the Revenue Act of 1938 and the applicable Treasury Regulations, (2) the adjusted basis of the property within the meaning of Section 113 (b) (1) (B), and (3) the amount realized upon the sale within the meaning of Section 111 (a) and (b).

STATUTES AND REGULATIONS INVOLVED

The statutes and Regulations involved will be found in the Appendix, *infra*, pp. 35–38.

STATEMENT

The parties filed a stipulation of facts (R. 14–34) which was adopted by the Tax Court as

part of its findings of fact. (R. 35.) The stipulated facts not set forth in the Tax Court's findings were expressly included by reference. The findings of the Tax Court (R. 35–38) may be summarized as follows:

The taxpayer was the sole legatee and devisee of her husband, who died on January 11, 1932, and was also the executrix of his estate. The decedent owned an apartment house, which at the time of his death was subject to a mortgage in the amount of $255,000, and on which there was due accrued interest in the amount of $7,042.50, so that the total lien on the property was $262,042.50. For the purpose of the federal estate tax, the propery was appraised as of the date of decedent's death at a value of $262,042.50, the exact amount due on the mortgage. (R. 35–36.)

On February 1, 1932, and at all times thereafter until the property was sold in November, 1938, the mortgage was in default for the nonpayment of interest. (R. 36.) In the early part of 1932 the taxpayer and the mortgagee entered into an agreement whereby the taxpayer was to operate the apartment house property, collect the rents, and pay for all necessary repairs and other expenses, reserve $200 a month for the payment of taxes, and remit the balance to the mortgagee at the end of each month on account of the mortgage. (R. 36.) The *net* rentals from the premises for the years 1932 to 1938, inclusive, were paid to

the mortgagee by the taxpayer in accordance with the agreement. (R. 36.)

In 1938 when the mortgagee was about to foreclose the mortgage, the taxpayer, in order to avoid such action, entered into a contract to sell the property *subject to the mortgage* for a cash consideration of $3,000. Pursuant to the contract, the taxpayer conveyed the property on November 29, 1938, and received $3,000 in cash, out of which she paid expenses in the amount of $500. The taxpayer was not a party to the mortgage, and did not at any time assume any personal liability upon the mortgage. (R. 36–37.)

Taxpayer filed income tax returns for the estate and for herself for the years between the death of decedent and the sale of the propery, in which she reported the rentals from the apartment house as gross income, and claimed deductions for interest paid on the mortgage and for the taxes and operating expenses of the property. She claimed deductions for depreciation each year, ranging from $3,200 to $3,900, and aggregating $25,500. (R. 37.)

In her return for 1938, the taxpayer reported a capital gain of $2,500 from the sale of the apartment house property, and included one-half, or $1,250, in her income. The Commissioner determined that the taxpayer sustained a capital loss of about $500 from the sale of the land, and that she realized an ordinary gain of about $24,000

from the sale of the building. (R. 38.) The taxpayer sought a review of the Commissioner's determination in the Tax Court, which decided in favor of the taxpayer; it held that the basis of the property was zero, that no depreciation allowance could be made on such a basis, and that the gain was limited to $2,500, which represented the total "amount realized." (R. 43.) Two members of the Tax Court dissented. (R. 45.) The Commissioner appealed to the Circuit Court of Appeals, which reversed the decision of the Tax Court, with Judge Swan dissenting. (R. 53–57.)

SUMMARY OF ARGUMENT

The amount of gain realized by the taxpayer upon the sale of the apartment house which she inherited under the will of her husband is the difference between the amount realized and the adjusted basis. Accordingly, it is necessary under the statute to ascertain first the unadjusted basis, secondly, the adjusted basis, and finally the amount realized.

1. The principal controversy in regard to the unadjusted basis is whether the word "property" in the statute and Regulations means the physical thing, the apartment house, or the taxpayer's net cash interest in the apartment house. The value of the apartment house was about $262,000, whereas the taxpayer's net cash interest in it on the critical date was zero. This Court has held

that the words of a statute are to be interpreted in their usual, ordinary and everyday meaning; and that this rule applies to taxing acts. Property ordinarily connotes ownership and ownership relates to the physical thing without taking into account any liens or encumbrances. If Congress had intended to make the taxpayer's net cash interest on the date of acquistion the basis for determining gain or loss, it would have used an appropriate term like "cash interest," "equity," or "equity of redemption."

The taxpayer in this case was the sole owner of the property from the date of her husband's death, and she alone had the right to possess, use and dispose of it. She collected the rents and paid the operating expenses. She claimed and was allowed depreciation on the basis of the full value of the apartment house without any reduction on account of the mortgage. She paid interest on the mortgage while she was in possession of the property and claimed and was allowed deductions for interest just as though she were the mortgagor. She reported the rentals as gross income and claimed deductions for the operating expenses of the property. She paid taxes on the property and claimed deductions in income tax returns on that account. When she sold the property, she sold the physical property itself.

The phraseology of the Regulations and the reference in the Regulations to the federal estate

tax clearly show that the value of the physical thing, rather than the value of taxpayer's net cash interest was intended as the basis of the property.

It would be unreasonable to construe the Regulations as meaning the taxpayer's net cash interest in the property, for such a construction would introduce administrative complication and confusion.

The construction of the word "property" in the statute and the Regulations is a question of law. Therefore the court below was free to reverse the decision of the Tax Court on the ground that it had erred on questions of law.

2. The Revenue Act expressly provides for the adjustment of the basis on account of depreciation to the extent allowed, but not less than the amount allowable. That provision is merely a legislative enactment of a rule laid down by this Court, which decided that the basis would have to be adjusted on account of depreciation in order to determine gain or loss even though the statute under consideration did not expressly require it.

In this case, the land was not subject to depreciation and therefore its basis need not be adjusted. But in regard to the building the taxpayer had been allowed depreciation in the aggregate amount of $25,500, and the amount allowable could readily be computed from the unadjusted basis of the building, the stipulated rate of depreciation and

the period during which it was held by the taxpayer.

Whether the taxpayer received a tax benefit from the depreciation allowance is immaterial, because this Court has decided that even though the taxpayer does not receive a tax benefit from depreciation, the basis must be adjusted on account of depreciation.

3. In regard to the amount realized, the word "property" in the statute should be construed in the same manner that it was construed in the basis provision so that the symmetry of the Act may be preserved. If the word "property" means the physical thing, the fair market value of the real estate sold by the taxpayer was $258,000 because the purchaser bought the property subject to a mortgage of $255,000 and paid $3,000 in cash. Obviously, he could have paid off the mortgage and owned the property free and clear at a cost of $258,000. If we are right that the basis of the property included the $255,000 mortgage, it would be absurd to eliminate the mortgage from the selling price and to say that the taxpayer sold the property for $3,000 gross or $2,500 net. That would result in a loss of more than $200,000 for the taxpayer, although she concedes and the Tax Court decided that she realized a gain of $2,500. The only way in which a reasonable result could be obtained is to add the principal amount of the mortgage to the amount of cash received.

Since the parties stipulated how the selling price should be allocated between the land and the building, it is a simple matter to ascertain the gain or loss on the sale of the land and the building. The gain on the building roughly approximates the amount of depreciation accrued during the period the taxpayer held it.

While the taxpayer did not assume personal liability on the mortgage, she stood in the shoes of the mortgagor, enjoyed all the tax benefits to which the mortgagor was entitled and attempted to meet the obligations of the mortgage. Under such circumstances it is not unreasonable to treat her as though she were the mortgagor.

ARGUMENT

INTRODUCTORY

Section 111 (a) of the Revenue Act of 1938 (Appendix, *infra*) provides in part that the gain from the sale of property shall be the excess of the amount realized therefrom over the adjusted basis provided in Section 113 (b) (Appendix, *infra*) for determining gain. Section 113 (b) requires an adjustment of the unadjusted basis of property as defined in Section 113 (a) (Appendix, *infra*). Therefore, the first step in determining the amount of gain realized by the taxpayer is to ascertain the unadjusted basis of the property within the meaning of Section 113 (a), and the second step is to determine the ad-

justed basis within the meaning of Section 113 (b). The third and last step is to ascertain the amount realized from the sale of the property within the meaning of Section 111 (a), which in turn is defined in Section 111 (b) as the sum of any money received plus the fair market value of the property (other than money) received.

I. UNADJUSTED BASIS

The property in question consisted of an apartment house and the land on which it stood, which the taxpayer acquired as sole devisee under the will of her husband who died in 1932. For the purpose of the federal estate tax, the property was appraised as of the date of his death at a value of $262,042.50. The unadjusted basis applicable here is defined by Section 113 (a) (5), which provides that the basis of property acquired by bequest, devise, or inheritance "shall be the fair market value of such property at the time of such acquisition." Article 113 (a) (5)-1 of Treasury Regulations 101 (Appendix, *infra*) provides that the time of the acquisition of such property is the death of the decedent, and that the value of property as of the date of the death of the decedent as appraised for the purpose of the federal estate tax shall be deemed to be its fair market value at the time of the death of the decedent.

In regard to the unadjusted basis the principal controversy is whether the word "property" in

the statute and Regulations means the physical thing, the apartment house, or the taxpayer's net cash interest in the apartment house. The value of the apartment house was $262,042.50. (R. 36.) At the time of the decedent's death, the property was subject to a mortgage in the amount of $255,000 principal and $7,042.50 accrued interest, or an aggregate sum of $262,042.50, which meant that the taxpayer had a net cash interest in the property on the date of her husband's death of zero. (R. 36.) This Court has held that the words of a statute are to be interpreted in their usual, ordinary and everyday meaning; and that this rule applies to taxing acts. *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 560–561. "Property" ordinarily connotes ownership (*Legal Tender Cases,* 79 U. S. 457, 551), or the right to possess, use and dispose of the physical thing (*United States* v. *General Motors Corp.,* 323 U. S. 373, 377–378). The statute has been consistently so construed.

The point was squarely decided more than ten years ago in *City Bank Farmers Trust Co.* v. *Bowers,* 68 F. 2d 909 (C. C. A. 2d), certiorari denied, 292 U. S. 644. That case involved an estate tax case where the decedent's securities amounting to $1,049,000 had been pledged with a bank to secure loans in the sum of $557,000. In assessing the tax the Commissioner included in the gross estate the total value of the pledged

securities instead of only the surplus after deducting the loans. The estate contended that the statute, properly interpreted, meant to include in the gross estate only the excess of the pledged securities over the amount of the obligation. This contention was rejected in language which is equally pertinent here. The court said (p. 913):

> The last question is whether the pledged securities should be excluded from the gross estate up to the amount of the loans. The statute, section 403 (a) (1), plainly meant the opposite; among the deductions allowed were "unpaid mortgages," an impossible item unless the whole value of the mortgaged property is to be included in the gross estate under section 402 (a), 40 Stat. 1097, as an "interest * * * subject to the payment of the charges against his estate." The regulations under the Act of 1918 (article 15, Regulations 37), specifically so provided; and their successors as well. Section 402 (a) was reenacted in 1921 and 1924 without change, though under a different section number; it is most unlikely that a contrary intent should have escaped expression for so long. * * *.

Moreover, the statute refers specifically to the situs of the physical property. Section 303 (a) (1) of the Revenue Act of 1926, c. 27, 44 Stat. 9, allows a deduction for unpaid mortgages upon property "except in the case of a resident decedent, where such property is not situated in the

United States." The quoted provision came into the law in the Revenue Act of 1921, c. 136, Sec. 403 (a) (1), 42 Stat. 227, after the Attorney General had ruled, 31 Op. A. G. 287 (1918), that under an earlier Act real estate located outside of the United States, belonging to a resident of the United States at the time of his death, was not to be included in determining the value of the gross estate. S. Rep. No. 275, 67th Cong., 1st Sess., p. 24. This seems clearly to negative the taxpayer's contention (Br. 36) that the gross estate includes only the decedent's equity in mortgaged property.

In this case, notwithstanding the mortgage, the taxpayer was the sole owner of the entire property and she alone had the right to possess, use and dispose of it. She collected the rents and paid the operating expenses. (R. 36.) She claimed and was allowed depreciation by the Commissioner on the basis of the full value of the apartment house without any reduction on account of the mortgage. (R. 37.)[1] She paid interest on the mortgage while she was in possession of the property (R. 36) and claimed and was allowed deductions for interest by the Commissioner (R. 37)

[1] The Treasury has consistently allowed taxpayers who acquire real estate by bequest subject to a mortgage to take depreciation on the basis of the full value of the property without any reduction on account of the mortgage.

just as though the mortgage debt were her debt.[2] She reported the rentals from the apartment house as gross income and claimed deductions for the operating expenses of the property. (R. 37.) She paid taxes on the property, and claimed deductions in income tax returns on that account.[3] When she sold the property in the taxable year she conveyed the physical property itself, as shown by the deed of sale. (R. 32.)

In fact, the Tax Court decided that the taxpayer used the property in her trade or business, in passing upon the question whether the apartment house was a capital asset within the meaning of Section 117 of the Revenue Act of 1938. (R. 44.) This part of the Tax Court's decision cannot be reconciled with its conclusion in regard to the unadjusted basis, because in its discussion in regard to Section 117, the Tax Court used the

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[2] This was in accordance with Treasury Regulations of long standing, which treated her as though she were directly liable on the mortgage and as though the mortgage debt were her debt. See Treasury Regulations 45, Art. 124; Treasury Regulation 62, Art. 124; Treasury Regulations 65, Art. 124; Treasury Regulations 69, Art. 124; Treasury Regulations 74, Art. 141; Treasury Regulations 77, Art. 141; Treasury Regulations 86, Art. 23 (b)–1; Treasury Regulations 94, Art. 23 (b)–1; Treasury Regulations 101, Art. 23 (b)–1; Treasury Regulations 103, Sec. 19.23 (b)–1; Treasury Regulations 111, Sec. 29.23 (b)–1.

[3] In general, taxes are deductible only by the person upon whom they are imposed; the vendee of real estate cannot claim a deduction on account of paying the vendor's taxes. See *Magruder* v. *Supplee*, 316 U. S. 394, 396, 398, 399.

word "property" in the sense of the physical thing, whereas in its discussion in regard to unadjusted basis, the Tax Court used "property" in the sense of net cash interest. No reason was given why the word should have different meanings in different sections of the same statute.

If Congress had intended to make the taxpayer's net cash interest on the date of acquisition the basis for determining gain or loss, it probably would have used a term like "cash interest," "equity," "equity of redemption";[1] that would be a more accurate description. If the Tax Court is correct in assuming that the word "property" in the statute refers to equity or net cash interest and the taxpayer sold only an equity in the property, the purchaser from the taxpayer acquired only an equity, so that his basis for gain

[1] See Section 81.38 of Treasury Regulations 105, where reference is made to the equity of redemption (or value of the property, less the indebtedness). This provision of the Regulations first appeared in 1937 pursuant to T. D. 4729, 1937–1 Cum. Bull. 284, 289, amending Article 38 of Treasury Regulations 80 (1934 ed.). The purpose of this provision in the Regulations was to avoid putting the full value of physical property in the gross estate, where the estate could not claim a deduction on account of unpaid mortgages. The statutory provision in regard to deductions on account of unpaid mortgages is limited to cases where they were incurred or contracted bona fide and for an adequate and full consideration in money or money's worth. See also Section 3482 of the Internal Revenue Code, relating to the stamp tax, where the value of any lien or encumbrance is expressly excluded from the value of the property conveyed; and Treasury Regulations 71, Section 113.82.

or loss and for depreciation (see Section 114 (Appendix, *infra*)) is the amount of cash paid for the equity, namely, $3,000.[5]

Moreover, the phraseology of the Regulations confirms the view that the value of the physical thing, rather than the value of taxpayer's net cash interest in the physical thing, was intended. Article 113 (a) (5)–1 of Treasury Regulations 101 provides in subdivision (c) that the basis of property acquired by devise is the value of the property as of the date of the death of the decedent *as appraised* for the purpose of the federal estate tax. This provision of the Treasury Regulations has been in effect since 1918,[6] and the statutory provision to which it refers has been reenacted in substantially the same form in all succeeding Revenue Acts.[7] Therefore the

[5] This would be contrary to the generally prevailing accounting practice. See II Kester, Accounting Theory and Practice (2d ed., 1925) 333; also, 1944 P-H, par. 60,512.

[6] See Treasury Regulations 45, Art. 1562; Treasury Regulations 62, Art. 1563; Treasury Regulations 65, Art. 1594; Treasury Regulations 69, Art. 1594; Treasury Regulations 74, Art. 596; Treasury Regulations 77, Art. 596; Treasury Regulations 86, Art. 113 (a) (5)–1 (c); Treasury Regulations 94, Art. 113(a)(5)–1(c); Treasury Regulations 101, Art. 113 (a) (5)–1 (c); Treasury Regulations 103, Sec. 19.113 (a) (5)–1 (c); Treasury Regulations 111, Sec. 29.113 (a) (5)–1 (c).

[7] Sec. 202 (a) (3) of the Revenue Act of 1921, c. 136, 42 Stat. 227; Sec. 204 (a) (5) of the Revenue Act of 1924, c. 234, 43 Stat. 253; Sec. 204 (a) (5) of the Revenue Act of 1926, c. 27, 44 Stat. 9; Sec. 113 (a) (5) of the Revenue Act of 1928, c. 852, 45 Stat. 791; Sec. 113 (a) (5) of the Revenue Act of 1932, c. 209, 47 Stat. 169; Sec. 113 (a) (5) of the Revenue Act

regulation is entitled to great weight. See *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114–115; *Merchants Bank* v. *Commissioner*, 320 U. S. 256, 260. The word "appraised" in the regulations suggests that reference was being made to the physical property rather than the equity which is computed from the appraised value.

In recognition of the statutory deduction for mortgages, Article 38 of Treasury Regulations 70 (1929 ed.) provides that the full value of real estate without any deduction for mortgages *must* be included in the gross estate and that the amount of any mortgage may be deducted to the extent that it was incurred or contracted bona fide for an adequate and full consideration in money or money's worth.[8] This regulation was followed by

of 1934, c. 277, 48 Stat. 680; Sec. 113 (a) (5) of the Revenue Act of 1936, c. 690, 49 Stat. 1648; Sec. 113 (a) (5) of the Revenue Act of 1938, c. 289, 52 Stat. 117; Sec. 113 (a) (5) of the Internal Revenue Code, as amended by Sec. 144 of the Revenue Act of 1942, c. 619, 56 Stat. 798.

[8] Under later Treasury Regulations it is mandatory to include the full value of the property subject to the mortgage in the gross estate if the decedent's estate is liable for the amount of the mortgage or indebtedness. But if the decedent's estate is not so liable, only the value of the equity of redemption (or value of the property, less the indebtedness) need be returned as part of the value of the gross estate. See Treasury Regulations 105, Sec. 81.38. This change in the Regulations first appeared in 1937 as T. D. 4729 (see fn. 4, *supra*). Since the decedent in this case died in 1932 and Treasury Regulations 70 (1929 ed.) were not amended, the changed regulation would not seem to be applicable. The record in this case does not clearly indicate whether the decedent assumed liability on the mortgage or not.

the taxpayer as executrix of her husband's estate, because the Tax Court found as a fact that the property was reported at the value of $262,042.50, and the amount due on the mortgage was reported as indebtedness of the estate in the same amount. (R. 36.)

We submit that the word "property" in the statute and the Treasury Regulations should properly be construed as the physical thing and not as the devisee's equity or net cash interest in the property. If we are correct, the unadjusted basis of the property within the meaning of the Treasury Regulations would be $262,042.50. The stipulation of facts shows that of this sum, $55,000 should be allocated to the land and the balance, or $207,042.50, should be allocated to the building. (R. 15.) It may be pointed out that the Tax Court in its opinion paid no attention to the estate tax regulations, although they were relied upon by the Government in its brief. In fact the Tax Court cited no authorities and gave no reasons for its conclusion in regard to the unadjusted basis of the property.

But assuming for the purposes of the argument that the applicable statute and regulation could reasonably be construed as meaning either the value of the physical thing or the taxpayer's net cash interest in the property, it would introduce administrative complication and confusion if the devisee's equity, rather than the value of

the physical thing, were to be treated as the proper basis. While the question involved in this case is the basis for determining gain or loss, the basis for depreciation is necessarily involved because Section 114 of the Revenue Act of 1938 (Appendix, *infra*) provides that the basis for depreciation shall be the same as the basis for gain or loss. Since depreciation is defined in the statute * as exhaustion, wear and tear of property, it could not reasonably be based upon the taxpayer's financial interest in the property, but only upon the value of the physical thing itself. The court below was impressed with the difficulties attendant upon making taxpayer's equity the basis. Suppose, for example, that a taxpayer inherits business property with a fair market value

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* See Section 23 (l) of the Revenue Act of 1938. It may be noted that Congress has treated the life tenant as though he were the absolute owner with respect to the deduction for depreciation; and has provided in the case of property held in trust that the allowable deduction should be apportioned on the basis of the trust income allocable to each beneficiary, in the absence of other provisions in the trust instrument.

The policy seems to be to give the allowance to the person who reports the income and the Commissioner's practice in dealing with mortgaged property promotes that policy. If he had made a distinction between those liable on a mortgage and those not, the full depreciation on literally thousands of pieces of property would not be reflected in any income tax return. There is no authority for taxpayer's suggestion that the mortgagee should have the allowance when the owner is not liable on the mortgage. The mortgagee does not use the property in his business and is accordingly foreclosed from receiving an allowance.

of $90,000, subject to an unassumed mortgage of $40,000, leaving as his equity $50,000; that he depreciates the property on a straight line basis on an estimated life of 20 years; and that he makes an annual $2,000 payment on mortgage principal. In the first year the depreciation on the equity is $2,500. For each successive year the basis will have to be adjusted to reflect the principal payments on the mortgage, and depreciation for previous years will have to be subtracted from the adjusted basis to determine the amount of depreciation allowable for the next succeeding year. Thus for the second year the depreciation will be [($50,000 plus $2,000) − $2,500] divided by 19, or a result of $2,605.26; for the third year $2,716.38; and for the fourth year $2,834.02. The depreciation allowances will increase progressively as the property's estimated life decreases; the nineteenth mortgage principal payment of $2,000 will be entirely depreciated within the twentieth year; and the property's estimated life will have expired before the twentieth payment of $2,000 on mortgage principal can be depreciated.

Moreover, if taxpayer fails to amortize the mortgage for a number of years and then under pressure of threatened foreclosure makes a substantial payment in one year, the consequence will be to compress a large allowance for depreciation within a relatively short period. Should the taxpayer in the above illustration make no

payments on the mortgage until the sixteenth year and then reduce the mortgage by $30,000, he will be entitled, under the taxpayer's contention, to depreciate the $30,000 capital outlay in the remaining five-year life of the property, together with the remaining five years' depreciation of his original equity interest.

Another result would be to set up a zero basis for the property in those cases where the amount of the mortgage equals the fair market value of the property on the critical date (the date of the decedent's death).

In this case the taxpayer claimed and was allowed deductions for depreciation based on the full value of the building on the date of the death of the decedent without any reduction on account of the mortgage. The deductions aggregated $25,500 (R. 37), which approximates the amount of gain determined by the Commissioner (R. 38). This is the first case in which the practice of the Treasury Department in using the full value of the property as the basis both for depreciation and for determining gain or loss has been challenged. It was undoubtedly for this reason that some of the federal tax services adversely criticized the opinion of the Tax Court in this case.[10] The court below said in its opinion (R. 55):

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[10] 1944 P-H, par. 60,512; 1944 C. C. H., pars. 8843–8850, inclusive.

> We cannot doubt, especially in view of the long uniform practice, that the right "basis" for depreciation is the actual value of the buildings.

II. ADJUSTED BASIS

Section 113 (b) (1) (B) of the Revenue Act of 1938 provides that "proper adjustment in respect of the property shall in all cases be made * * * for exhaustion, wear and tear * * * to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws." Moreover, this Court had decided in a case arising under the Revenue Act of 1916, c. 463, 39 Stat. 756, as amended, which did not contain a provision similar to Section 113 (b) (1) (B) requiring adjustment of the basis on account of depreciation and depletion,[11] that the basis for determining gain or loss must be adjusted on account of depreciation and depletion to the extent allowable. *United States* v. *Ludey*, 274 U. S. 295. Incidentally, in the *Ludey* case the taxpayer did not deny that Congress had the power to require that the original cost should be adjusted on account of depreciation and depletion. 274 U. S. 295, 298. As this Court noted in its opinion, unless the statute is construed as

[11] Until 1924, none of the Revenue Acts provided in terms that, in computing the gain from a sale of any property, a deduction shall be made from the original cost on account of depreciation and depletion during the period of operation.

requiring an adjustment of the basis on account of depreciation, the taxpayer would get a double deduction for the loss of the same capital assets.

The taxpayer herein filed income tax returns for the estate of the decedent covering the period January 11 (the date of decedent's death) to December 31, 1932, and for the years 1933, 1934, 1935 and 1936; and income tax returns for the years 1937 and 1938, in which she claimed deductions for depreciation in amounts ranging from $3,200 to $3,900, and aggregating $25,500. (R. 37.) While $25,500 represents the amount of depreciation allowed, the Commissioner determined that the amount allowable was $28,045.10. (R. 38.) Since the parties stipulated that of the sum of $262,042.50, $55,000 should be allocated to the land, and $207,042.50 to the improvements (R. 15), and that the rate of depreciation applicable to the apartment house is two per cent per annum (R. 17), the amount of depreciation, namely, $28,045.10, is merely a matter of simple computation.

Applying Section 113 (b) (1) (B) to the facts of this case, it is necessary to subtract the amount of depreciation allowable, namely, $28,045.10, from the part of the basis allocated to the apartment house building, namely, $207,042.50, in order to obtain the adjusted basis, namely, $178,997.40. (R. 38.) As to the part of the basis allocated to the land, namely, $55,000, there is no need to

adjust the basis because it is not subject to depreciation.

The Tax Court made no finding with respect to tax benefits. Presumably the Tax Court disagreed with the action of the Commissioner in adjusting the basis of the apartment house building by the amount of $28,045.10, only because it determined that the unadjusted basis was zero (R. 43.) The statute is clear and the principle upon which adjustments are made is universally accepted.

III. AMOUNT REALIZED

Section 111 (a) of the Revenue Act of 1938 provides that the gain from the sale or other disposition of property shall be the excess of the "amount realized" therefrom over the adjusted basis provided in Section 113 (b), and the amount realized is defined in Section 111 (b) as the "sum of any money received plus the fair market value of the property (other than money) received."

We have argued that the word "property" in Section 113 and in Article 113 (a) (5)–1 of Treasury Regulations 101 means the physical thing, rather than taxpayer's net cash interest or equity in the property, or the value of the property less the mortgage. Under this construction of the statute, the basis of the land (which is not subject to adjustment on account of depreciation) is $55,000 as shown by the discussion under Point I, *supra*, and the adjusted basis of the building is $178,997.40, as shown under Point II, *supra*. If

the word "property" in Section 113 means the physical thing and the amount of the mortgage is not deducted for the purpose of ascertaining the basis, it would seem to follow that the word "'property" in Section 111 must mean the same thing and that the amount of the mortgage should not be deducted. Only in this way may the symmetry of the statutory scheme be preserved. See *Maguire* v. *Commissioner*, 313 U. S. 1, 8.

If the word "property" in Section 111 means the physical thing, the fair market value of the real estate sold by the taxpayer on November 29, 1938, was the amount of cash paid, $3,000, plus the amount of the mortgage, because the taxpayer's vendee could have owned the property free and clear of the mortgage on the day of the sale by paying $255,000 to the mortgagee.[12] Since the property was in effect sold for $258,000, it is fair to say that the fair market value of the real estate on the day of the sale was $258,000. See *Rogers* v. *Helvering*, 107 F. 2d 394, 396 (C. C. A. 2d); *Robertson* v. *Routzahn*, 75 F. 2d 537, 539 (C. C. A. 6th); *New York* v. *Sage*, 239 U. S. 57, 61.

Assuming that $258,000 was the fair market value of the real estate, that the land and building are what was sold, rather than taxpayer's

[12] We may disregard for tax purposes the amount of outstanding interest, taxes, etc., because they were deductible from gross income or from the proceeds of sale.

equity in the property and that the basis included the value of the mortgage, it would be absurd to say that the taxpayer realized only $3,000 gross, or $2,500 net, from the sale. It would mean that the taxpayer would suffer a loss of $54,471.15[13] on the sale of the land, and a loss of $177,026.25,[14] on the sale of the building, although she concedes, and the Tax Court decided, that she realized a gain of at least $2,500. Furthermore, it would mean that the purchaser from the taxpayer has a basis for depreciation, as well as for gain or loss, of only $3,000, which is contrary to the generally prevailing accounting

[13] Since the basis is $55,000 and the total amount realized for the land and building would be $2,500 and the parties stipulated that the proportion of the selling price allocable to the land is $\frac{5,447,115}{25,750,000}$ (R. 17), the amount of the selling price allocated to the land would be $528.85. The excess of the basis, $55,000, over the part of the selling price allocable to the land, $528.85, represents a loss on the transaction in the amount of $54,471.15. Since the land is a capital asset under Section 117 and it was held for more than 24 months, only one-half of this amount would be recognized as a deductible loss.

[14] Since the adjusted basis for the building is $178,997.40 and the total amount realized for the land and building would be $2,500 and the parties stipulated that the proportion of the selling price allocable to the building is $\frac{20,302,885}{25,750,000}$ (R. 17), the amount of the selling price allocated to the building would be $1,971.15. The excess of the basis, $178,997.40, over the part of the selling price allocable to the building, $1,971.15, represents a loss of $177,026.25. Since the building is not a capital asset under Section 117, the entire loss would be deductible on the sale of the building.

practice. See fn. 5, *supra*, p. 16. The only way in which a reasonable result can be reached is to add the principal amount of the mortgage to the amount of cash received. See *Estate of Ebert* v. *Commissioner*, 37 B. T. A. 186, which the Tax Court failed to distinguish in its opinion in the instant case.

Perhaps it is sufficient to say that the amount of the mortgage must be included in the computation of the "amount realized" because the amount of the mortgage is included in the basis. Thus its inclusion in the amount realized can be justified solely on the ground that that is a condition for permitting the taxpayer to include it in the basis. The taxpayer contends that the amount of the mortgage should be disregarded both in the basis and in the amount realized. She does not contend that if it is included in the basis it should nevertheless be excluded from the amount realized. It is implicit in her argument, and we think there can be no doubt, that there must be similar treatment at both ends of the transaction. The Regulations provide that whatever basis is used for estate tax purposes must similarly be used as the basis by the devisee. Accordingly, since we think we have established that Congress intended that the amount of the mortgage should be reflected in the value of the property for estate tax purposes, it should follow that the amount of the mortgage must be included in the amount realized.

The Tax Court said in its opinion that if the taxpayer had assumed liability for the payment of the mortgage debt and her vendee had in turn assumed taxpayer's liability, such assumption by the vendee would be the equivalent of the receipt of "money" by the taxpayer to the extent of the amount of the liability so assumed. (R. 41.) While the taxpayer did not assume liability on the mortgage, she held the apartment house subject to the conditions and covenants of the mortgage. She was the owner for all purposes; she had all the income; she managed it; she sold it and the increase in value went to her. The mortgagee (the bank), on the other hand, was nothing more than a preferred creditor, even though the taxpayer was not liable on the debt. While it is true that the mortgagee had recourse only to the property, it was a creditor nonetheless. The taxpayer paid the bank interest on the mortgage, and by paying $2,500 in back interest she obtained from the bank a reduction in the interest rate to four percent (R. 25–26).

When the taxpayer sold the property subject to the mortgage, she secured a release from a charge upon her property just as though the purchaser had paid her the full price on condition that before he took title the lien should be cleared.[15] Therefore she

[15] The same is true of a gift. Since the release similarly may be considered as received by a donor of real estate subject to a mortgage, it is not surprising that the value of the gift is only the amount of the donor's equity. Taxpayer's

received property other than money when she sold the property subject to the mortgage and the fair market value of the property was the principal amount of the mortgage, namely, $255,000. In this connection the court below said (R. 55–56):

> She insists, however, that because she was not liable, the lien should not be considered as an equivalent. But the lien of a mortgage does not make the mortgagee a co-tenant; the mortgagor is the owner for all purposes; indeed that is why the "gage" is "mort," as distinguished from a "vivum vadium." *Kortright* v. *Cady*, 21 N. Y. 343, 344. He has all the income from the property; he manages it; he may sell it; any increase in its value goes to him; any decrease falls on him, until the value goes below the amount of the lien. The mortgagee is a creditor, and in effect nothing more than a preferred creditor, even though the mortgagor is not liable for the debt. He is not the less a creditor because he has recourse only to the land, unless we are to deny the term to one who may levy upon only a part of his debtor's assets. When therefore upon a sale the mortgagor makes an allowance to the vendee of the amount of the lien, he secures a release from a charge upon his property quite as though the vendee had paid him the full price on con-

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argument (Br. 37–38) ignores the fact that in computing both estate and gift taxes the amount of the mortgage is ultimately excluded.

dition that before he took title the lien should be cleared, or as though it were a condition upon the sale of Whiteacre that the vendee should clear the vendor's Blackacre of a mortgage. In neither case would anyone question the conclusion that the vendor had received "property (other than money)"; yet the effect is precisely the same of the transaction at bar.

There is another way of illustrating that the taxpayer realized a substantial gain upon the sale of the apartment house, although the actual cash received was only $3,000 gross or $2,500 net. While the taxpayer sold the same apartment house which she inherited from her husband about seven years earlier, seven years of the useful life of the apartment house had been used up in the meantime. Assume that the apartment house building was worth about $200,000 when the taxpayer acquired it and that its useful life was 50 years; it might be said to consist of 50 units of $4,000 each. When the taxpayer sold it, it consisted of only 43 units of $4,000 each, because seven of those units had been used up. Therefore, even though the taxpayer sold the building for the same amount as the value at the time she acquired it seven years earlier, she would nevertheless have realized a gain of $28,000. As a matter of fact, the portion of the selling price allocated to the building by stipulation of the parties was about $4,000 less than the portion

of the basis allocated to the building (R. 38), so that the net gain on the building was about $24,000.

It may be noted that in recent income tax legislation, Congress has made no distinction for basis purposes between the acquisition of property subject to a liability and the assumption of liability. See Section 213 (d) of the Revenue Act of 1939, c. 247, 53 Stat. 862, amending Section 113 (a) (6) of the Internal Revenue Code. The Treasury Regulations relating to installment sales have provided that no distinction shall be drawn between cases where property is taken subject to a mortgage and cases where the mortgage is assumed by the purchaser.[16]

The Tax Court summarily disposed of this regulation on the ground that it was limited to installment sales. That reasoning is obviously too superficial. The Regulations embody a principle which the Tax Court is required to follow, if applicable. The principle has not been limited to installment sales. A taxpayer who is not liable on a mortgage is nevertheless regarded as making the sale upon a foreclosure. *Edward F. C. McLaughlin* v. *Commissioner*, 43 B. T. A. 528.

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[16] See Treasury Regulations 69, Art. 44; Treasury Regulations 74, Art. 352; Treasury Regulations 77, Art. 352; Treasury Regulations 86, Art. 44-2; Treasury Regulations 94, Art. 44-2; Treasury Regulations 101, Art. 44-2; Treasury Regulations 103, Sec. 19.44-2; Treasury Regulations 111, Sec. 29.44-2.

The taxpayer relies upon a recent decision of the Circuit Court of Appeals for the Fifth Circuit, *Hilpert* v. *Commissioner*, 151 F. 2d 929, to show that the amount realized by the taxpayer on the sale should not include the sum of $255,000 representing the unpaid principal of the mortgage. (Br. 29.) In the *Hilpert* case the Tax Court [17] assumed that the taxpayers were personally liable on the mortgage and held that since the redemption of the mortgage by taxpayers' vendee eliminated the indebtedness, the amount of the mortgage must be included in the amount realized. The Circuit Court of Appeals reversed the decision of the Tax Court on the ground that under the law of Florida no debt had been created; that the land was put up purely as a pledge under such circumstances that the courts deem it to be a mortgage, but the mortgagee could not enforce any personal liability against the taxpayers. We think that the decision of the Fifth Circuit was wrong for the reasons given by Judge Hutcheson in his dissenting opinion.[18]

In any event no consideration was given to the critical question here of the proper basis and the need for correlating the basis for depreciation with the computation of gain or loss

[17] 4 T. C. 473.

[18] See also discussion of the case in 59 Harv. L. Rev. 622 (1946); and in 24 Taxes 443 (May 1946).

upon sale. The same is true of the other cases which have drawn distinctions between taxpayers who are and those who are not personally liable on mortgages.

The taxpayer also argues that the result of the decision of the court below is to subject the mortgagor to a tax upon a gain which is out of all proportion to what she received in cash; to a tax which may indeed be greater than the whole cash consideration. (Br. 50, 51.) This reasoning ignores the past advantages which she was entitled to, including allowances for depreciation, which in this case aggregate $25,500.

The taxpayer argues that the reversal of the Tax Court by the court below was a violation of the rule of this Court in *Dobson* v. *Commissioner*, 320 U. S. 489. (Br. 14.) According to our interpretation of the *Dobson* case, the rule does not apply where the Tax Court has made a clear-cut mistake of law. See *Commissioner* v. *Wilcox*, 327 U. S. 404. We believe that the construction of the term "property" in Section 113 (a) (5) and of the term "amount realized" where the taxpayer sells property subject to a mortgage, which she acquired by bequest subject to a mortgage, are questions of law which were properly reviewed by the court below. See Section 1003 (b) of the Revenue Act of 1926, c. 27, 44 Stat. 9.

CONCLUSION

The decision of the court below is correct and should therefore be affirmed.

Respectfully submitted.

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NOVEMBER 1946.

APPENDIX

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

(a) *Computation of gain or loss.*—The gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 113 (b) for determining gain, and the loss shall be the excess of the adjusted basis provided in such section for determining loss over the amount realized.

(b) *Amount realized.*—The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money) received.

* * * * *

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(5) *Property transmitted at death.*—If the property was acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, the basis shall be the fair market value of such property at the time of such acquisition. * * *

* * * * *

(b) *Adjusted basis.*—The adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined

under subsection (a), adjusted as hereinafter provided.

(1) *General rule.*—Proper adjustment in respect of the property shall in all cases be made—

* * * * *

(B) in respect of any period since February 28, 1913, for exhaustion, wear and tear, obsolescence, amortization, and depletion, to the extent allowed (but not less than the amount allowable) under this Act or prior income tax laws. * * *

* * * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

(a) *Basis for Depreciation.*—The basis upon which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property.

* * * * * *

Treasury Regulations 101, relating to the Revenue Act of 1938:

ART. 113 (a) (5)–1. *Basis of property acquired by bequest, devise, or inheritance.*—* * *

(b) * * *

(1) *General rule.*—Except as prescribed in paragraph (2) the basis of property acquired from a decedent by will or under the law governing the descent and distribution of the property of decedents is the fair market value at the time of such acquisition. Since under the law governing wills and the distribution of the property of decedents, all titles to property acquired by bequest, devise, or inheritance relate back

to the death of the decedent, even though the interest of him who takes the title was, at the date of death of the decedent, legal, equitable, vested, contingent, general, specific, residual, conditional, executory, or otherwise, the time of the acquisition of such property is the death of the decedent. * * *

The purpose of the Act, in prescribing a general uniform basis rule for property acquired by bequest, devise, or inheritance, is, on the one hand, to tax the gain, in respect of such property, to him who realizes it (without regard to the circumstance that at the death of the decedent it may have been quite uncertain whether the taxpayer would take or gain anything); and, on the other hand, not to recognize as gain any element of value solely from the circumstance that the possession or enjoyment of the taxpayer was postponed. Such postponement may be, for example, until the administration of the decedent's estate is completed, until the period of the possession or enjoyment of another has terminated, or until an uncertain event has happened. It is the increase or decrease in the value of property reflected in a sale or other disposition which section 113 (a) (5) recognizes as the measure of gain or loss.

* * * * * *

(c) *Fair market value.*—For the purposes of this article, the value of property as of the date of the death of the decedent as appraised for the purpose of the Federal estate tax or if the property is not appraised as of the date of death of the decedent for such purpose or if the estate is not subject to such tax, its value as ap-

praised as of the date of the death of the decedent for the purpose of State inheritance or transmission taxes, shall be deemed to be its fair market value at the time of the death of the decedent.

* * * * *

(e) *Adjustments to basis.*—In the hands of every person who acquires the property of a decedent (or any estate or interest therein) by bequest, or devise, or inheritance, the basis of the property is always the same,

(1) whether such person be the executor or administrator, the heir, the legatee, the devisee, the trustee of a trust created by the will, or any beneficiary of such trust, and whatever the nature of any such person's interest or estate may be;

(2) whether during or after administration and settlement of the estate of the decedent, during or after the term of any trust under the will, or before or after the distribution by the executor or administrator, or the trustee.

Adjustments to basis required by section 113 (b) are made in accordance with the same principles. * * *

U. S. GOVERNMENT PRINTING OFFICE: 1944

SUPREME COURT OF THE UNITED STATES

No. 68.—October Term, 1946.

Beulah B. Crane, Petitioner, v. Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 14, 1947.]

Mr. Chief Justice Vinson delivered the opinion of the Court.

The question here is how a taxpayer who acquires depreciable property subject to an unassumed mortgage, holds it for a period, and finally sells it still so encumbered, must compute her taxable gain.

Petitioner was the sole beneficiary and the executrix of the will of her husband, who died January 11, 1932. He then owned an apartment building and lot subject to a mortgage,[1] which secured a principal debt of $255,000.00 and interest in default of $7,042.50. As of that date, the property was appraised for federal estate tax purposes at a value exactly equal to the total amount of this encumbrance. Shortly after her husband's death, petitioner entered into an agreement with the mortgagee whereby she was to continue to operate the property—collecting the rents, paying for necessary repairs, labor, and other operating expenses, and reserving $200.00 monthly for taxes—and was to remit the net rentals to the mortgagee. This plan was followed for nearly seven years, during which period petitioner reported the gross rentals as income, and claimed and was allowed deductions for taxes and operating expenses paid on the property, for interest paid on the mortgage, and for the physical exhaustion of

[1] The record does not show whether he was personally liable for the debt.

the building. Meanwhile, the arrearage of interest increased to $15,857.71. On November 29, 1938, with the mortgagee threatening foreclosure, petitioner sold to a third party for $3,000.00 cash, subject to the mortgage, and paid $500.00 expenses of sale.

Petitioner reported a taxable gain of $1,250.00. Her theory was that the "property" which she had acquired in 1932 and sold in 1938 was only the equity, or the excess in the value of the apartment building and lot over the amount of the mortgage. This equity was of zero value when she acquired it. No depreciation could be taken on a zero value.[2] Neither she nor her vendee ever assumed the mortgage, so, when she sold the equity, the amount she realized on the sale was the net cash received, or $2,500.00. This sum less the zero basis constituted her gain, of which she reported half as taxable on the assumption that the entire property was a "capital asset".[3]

The Commissioner, however, determined that petitioner realized a net taxable gain of $23,767.03. His theory was that the "property" acquired and sold was not the equity, as petitioner claimed, but rather the physical property itself, or the owner's rights to possess, use, and dispose of it, undiminished by the mortgage. The original basis thereof was $262,042.50, its appraised value in 1932. Of this value $55,000.00 was allocable to land and $207,042.50 to building.[4] During the period that petitioner held the

[2] This position is, of course, inconsistent with her practice in claiming such deductions in each of the years the property was held. The deductions so claimed and allowed by the Commissioner were in the total amount of $25,500.00.

[3] See § 117 (a) (b), Revenue Act of 1938, c. 289, 52 Stat. 447. Under this provision only 50% of the gain realized on the sale of a "capital asset" need be taken into account, if the property had been held more than two years.

[4] The parties stipulated as to the relative parts of the 1932 appraised value and of the 1938 sales price which were allocable to land and building.

property, there was an allowable depreciation of $28,045.10 on the building;[5] so that the adjusted basis of the building at the time of sale was $178,997.40. The amount realized on the sale was said to include not only the $2,500.00 net cash receipts, but also the principal amount[6] of the mortgage subject to which the property was sold, both totaling $257,500.00. The selling price was allocable in the proportion, $54,471.15 to the land and $203,028.85 to the building.[7] The Commissioner agreed that the land was a "capital asset", but thought that the building was not.[8] Thus, he determined that petitioner sustained a capital loss of $528.85 on the land, of which 50% or $264.42 was taken into account, and an ordinary gain of $24,031.45 on the building, or a net taxable gain as indicated.

The Tax Court agreed with the Commissioner that the building was not a "capital asset." In all other respects it adopted petitioner's contentions, and expunged the deficiency.[9] Petitioner did not appeal from the part of the ruling adverse to her, and these questions are no longer at issue. On the Commissioner's appeal, the Circuit Court

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[5] The parties stipulated that the rate of depreciation applicable to the building was 2% per annum.

[6] The Commissioner explains that only the principal amount, rather than the total present debt secured by the mortgage, was deemed to be a measure of the amount realized, because the difference was attributable to interest due, a deductible item.

[7] See *supra*, note 4.

[8] See § 117 (a) (1), Revenue Act of 1938, *supra*.

[9] 3 T. C. 585. The Court held that the building was not a "capital asset" within the meaning of § 117 (a) and that the entire gain on the building had to be taken into account under § 117 (b), because it found that the building was of a character subject to physical exhaustion and that petitioner had used it in her trade or business.

But because the Court accepted petitioner's theory that the entire property had a zero basis, it held that she was not entitled to the 1938 depreciation deduction on the building which she had inconsistently claimed.

For these reasons, it did not expunge the deficiency in its entirety.

of Appeals reversed, one judge dissenting.[10] We granted certiorari because of the importance of the questions raised as to the proper construction of the gain and loss provisions of the Internal Revenue Code.[11]

The 1938 Act,[12] § 111 (a), defines the gain from "the sale or other disposition of property" as "the excess of the amount realized therefrom over the adjusted basis provided in § 113 (b). . . ." It proceeds, § 111 (b), to define "the amount realized from the sale or other disposition of property" as "the sum of any money received plus the fair market value of the property (other than money) received." Further, in § 113 (b), the "adjusted basis for determining the gain or loss from the sale or other disposition of property" is declared to be "the basis under subsection (a), adjusted . . . [(1) (B)] . . . for exhaustion, wear and tear, obsolescence, amortization . . . to the extent allowed (but not less than the amount allowable). . . ." The basis under subsection (a) "if the property was acquired by . . . devise . . . or by the decedent's estate from the decedent", § 113 (a) (5), is "the fair market value of such property at the time of such acquisition."

Logically, the first step under this scheme is to determine the unadjusted basis of the property, under § 113 (a) (5), and the dispute in this case is as to the construction to be given the term "property". If "property", as used in that provision, means the same thing as "equity", it would necessarily follow that the basis of petitioner's property was zero, as she contends. If, on the contrary, it means the land and building themselves, or the owner's legal rights in them, undiminished by the mortgage, the basis was $262,042.50.

[10] 153 F. 2d 504.

[11] —— U. S. ——.

[12] All subsequent references to a revenue act are to this Act unless otherwise indicated. The relevant parts of the gain and loss provisions of the Act and Code are identical.

We think that the reasons for favoring one of the latter constructions are of overwhelming weight. In the first place, the words of statutes—including revenue acts—should be interpreted where possible in their ordinary, everyday senses.[13] The only relevant definitions of "property" to be found in the principal standard dictionaries [14] are the two favored by the Commissioner, *i. e.*, either that "property" is the physical thing which is a subject of ownership, or that it is the aggregate of the owner's rights to control and dispose of that thing. "Equity" is not given as a synonym, nor do either of the foregoing definitions suggest that it could be correctly so used. Indeed, "equity" is defined as "the value of a property . . . above the total of the liens. . . ." [15] The contradistinction could hardly be more pointed. Strong countervailing considerations would be required to support a contention that Congress, in using the word "property", meant "equity", or that we should impute to it the intent to convey that meaning.[16]

In the second place, the Commissioner's position has the approval of the administrative construction of § 113 (a) (5). With respect to the valuation of property under that section, Reg. 101, Art. 113 (a) (5)–1, promulgated under the 1938 Act, provided that "the value of property as of the date of the death of the decedent as appraised for the purpose of the federal estate tax . . . shall be deemed to be its fair market value. . . ." The land and building here involved were so appraised in 1932, and their appraised value—$262,042.50—was reported by petitioner as part of the gross estate. This was in accord-

[13] *Old Colony R. Co.* v. *Commissioner*, 284 U. S. 552, 560.

[14] See Webster's New International Dictionary, Unabridged, 2d Ed.; Funk & Wagnalls' New Standard Dictionary; Oxford English Dictionary.

[15] See Webster's New International Dictionary, *supra*.

[16] *Crooks* v. *Harrelson*, 282 U. S. 55, 59.

ance with the estate tax law [17] and regulations,[18] which had always required that the value of decedent's property, undiminished by liens, be so appraised and returned, and that mortgages be separately deducted in computing the net estate.[19] As the quoted provision of the Regulations has been in effect since 1918,[20] and as the relevant statutory provision has been repeatedly reenacted since then in substantially the same form,[21] the former may itself now be considered to have the force of law.[22]

Moreover, in the many instances in other parts of the Act in which Congress has used the word "property", or expressed the idea of "property" or "equity", we find no instances of a misuse of either word or of a confusion of the ideas.[23] In some parts of the Act other than the gain and loss sections, we find "property" where it is unmistakably used in its ordinary sense.[24] On the other hand,

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[17] See §§ 202 and 203 (a) (1), Revenue Act of 1916; §§ 402 and 403 (a) (1), Revenue Acts of 1918 and 1921; §§ 302, 303 (a) (1), Revenue Acts of 1924 and 1926; § 805, Revenue Act of 1932.

[18] See Reg. 37, Arts. 13, 14, and 47; Reg. 63, Arts. 12, 13, and 41; Reg. 68, Arts. 11, 13, and 38; Reg. 70, Arts. 11, 13, and 38; Reg. 80, Arts. 11, 13, and 38.

[19] See *City Bank Farmers Trust Co.* v. *Bowers*, 68 F. 2d 909, cert. denied, 292 U. S. 644; *Rodiek* v. *Helvering*, 87 F. 2d 328; *Adriance* v. *Higgins*, 113 F. 2d 1013.

[20] See also Reg. 45, Art. 1562; Reg. 62, Art. 1563; Reg. 65, Art. 1594; Reg. 69, Art. 1594; Reg. 74, Art. 596; Reg. 77, Art. 596; Reg. 86, Art. 113 (a) (5)–1 (c); Reg. 94, Art. 113 (a) (5)–1 (c); Reg. 103, § 19.113 (a) (5)–1 (c); Reg. 111, § 29.113 (a) (5)–1 (c).

[21] § 202 (a) (3), Revenue Act of 1921; § 204 (a) (5), Revenue Act of 1924; § 204 (a) (5), Revenue Act of 1926; § 113 (a) (5), Revenue Act of 1928; § 113 (a) (5), Revenue Act of 1932; § 113 (a) (5), Revenue Act of 1934; § 113 (a) (5), Revenue Act of 1936; § 113 (a) (5), Revenue Act of 1938; § 113 (a) (5), Internal Revenue Code.

[22] *Helvering* v. *Reynolds Co.*, 306 U. S. 110, 114.

[23] Cf. *Helvering* v. *Stockholms Bank*, 293 U. S. 84, 87.

[24] Sec. 23 (a) (1) permits the deduction from gross income of "rentals . . . required to be made as a condition to the continued

where either Congress or the Treasury intended to convey the meaning of "equity," it did so by the use of appropriate language.[25]

A further reason why the word "property" in § 113 (a) should not be construed to mean "equity" is the bearing such construction would have on the allowance of deductions for depreciation and on the collateral adjustments of basis.

Section 23 (l) permits deduction from gross income of "a reasonable allowance for the exhaustion, wear and tear of property. . . ." Sections 23 (n) and 114 (a) declare that the "basis upon which exhaustion, wear and tear . . . are to be allowed" is the basis "provided in Sec. 113 (b) for the purpose of determining the gain upon the sale" of the property, which is the § 113 (a) basis "adjusted . . . for exhaustion, wear and tear . . . to the extent allowed (but not less than the amount allowable). . . ."

Under these provisions, if the mortgagor's equity were the § 113 (a) basis, it would also be the original basis from which depreciation allowances are deducted. If it is, and if the amount of the annual allowances were to be computed on that value, as would then seem to be required,[26]

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use . . . for purposes of the trade or business, of *property* . . . in which he [the taxpayer] has no *equity*."

Sec. 23 (l) permits the deduction from gross income of "a reasonable allowance for the exhaustion, wear and tear of *property* used in the trade or business. . . ."

See also § 303 (a) (1), Revenue Act of 1926, c. 27, 44 Stat. 9; § 805, Revenue Act of 1932, c. 209, 47 Stat. 280.

[25] See § 23 (a) (1), *supra*, note 24; § 805, Revenue Act of 1932, *supra*, note 24; § 3482, I. R. C.; Reg. 105, § 81.38. This provision of the Regulations, first appearing in 1937, T. D. 4729, 1937-1 Cum. Bull. 284, 289, permitted estates which were not liable on mortgages applicable to certain of decedent's property to return "only the value of the equity of redemption (or value of the property, less the indebtedness). . . ."

[26] Secs. 23 (n) and 114 (a), in defining the "basis upon which" depreciation is "to be allowed", do not distinguish between basis as the

they will represent only a fraction of the cost of the corresponding physical exhaustion, and any recoupment by the mortgagor of the remainder of that cost can be effected only by the reduction of his taxable gain in the year of sale.[27] If, however, the amount of the annual allowances were to be computed on the value of the property, and then deducted from an equity basis, we would in some instances have to accept deductions from a minus basis or deny deductions altogether.[28] The Commissioner also argues that taking the mortgagor's equity as the § 113 (a) basis would require the basis to be changed with each payment on the mortgage,[29] and that the attendant problem of repeatedly recomputing basis and annual allowances would be a tremendous accounting burden on both the Commissioner and the taxpayer. Moreover, the mortgagor would acquire control over the timing of his depreciation allowances.

Thus it appears that the applicable provisions of the Act expressly preclude an equity basis, and the use of it is contrary to certain implicit principles of income tax depreciation, and entails very great administrative difficul-

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minuend from which the allowances are to be deducted, and as the dividend from which the amount of the allowance is to be computed. The Regulations indicate that the basis of property is the same for both purposes. Reg. 101, Art. 23 (l)–4, 5.

[27] This is contrary to Treasury practice, and to Reg. 101, Art. 23 (l)–5, which provides in part:

"The capital sum to be recovered shall be charged off over the useful life of the property, either in equal annual installments or in accordance with any other recognized trade practice, such as an apportionment of the capital sum over units of production."

See *Detroit Edison Co.* v. *Commissioner*, 319 U. S. 98, 101.

[28] So long as the mortgagor remains in possession, the mortgagee can not take depreciation deductions, even if he is the one who actually sustains the capital loss, as § 23 (l) allows them only on property "used in the trade or business."

[29] Sec. 113 (b) (1) (A) requires adjustment of basis "for expenditures . . . properly chargeable to capital account. . . ."

ties.[20] It may be added that the Treasury has never furnished a guide through the maze of problems that arise in connection with depreciating an equity basis, but, on the contrary, has consistently permitted the amount of depreciation allowances to be computed on the full value of the property, and subtracted from it as a basis. Surely, Congress' long-continued acceptance of this situation gives it full legislative endorsement.[21]

We conclude that the proper basis under § 113 (a) (5) is the value of the property, undiminished by mortgages thereon, and that the correct basis here was $262,042.50. The next step is to ascertain what adjustments are required under § 113 (b). As the depreciation rate was stipulated, the only question at this point is whether the Commissioner was warranted in making any depreciation adjustments whatsoever.

Section 113 (b) (1) (B) provides that "proper adjustment in respect of the property *shall in all cases be made* . . . for exhaustion, wear and tear . . . to the extent allowed (but not less than the amount allowable). . . ." The Tax Court found on adequate evidence that the apartment house was property of a kind subject to physical exhaustion, that it was used in taxpayer's trade or business, and consequently that the taxpayer would have been entitled to a depreciation allowance under § 23 (l), except that, in the opinion of that Court, the basis of the property was zero, and it was thought that depreciation could not be taken on a zero basis. As we have just decided that the correct basis of the property was not

[20] Obviously we are not considering a situation in which a taxpayer has acquired and sold an equity of redemption only, *i. e.*, a right to redeem the property without a right to present possession. In that situation, the right to redeem would itself be the aggregate of the taxpayer's rights and would undoubtedly constitute 'property' within the meaning of § 113 (a). No depreciation problems would arise. See note 28.

[21] See note 22.

zero, but $262,042.50, we avoid this difficulty, and conclude that an adjustment should be made as the Commissioner determined.

Petitioner urges to the contrary that she was not entitled to depreciation deductions, whatever the basis of the property, because the law allows them only to one who actually bears the capital loss,[32] and here the loss was not hers but the mortgagee's. We do not see, however, that she has established her factual premise. There was no finding of the Tax Court to that effect, nor to the effect that the value of the property was ever less than the amount of the lien. Nor was there evidence in the record, or any indication that petitioner could produce evidence, that this was so. The facts that the value of the property was only equal to the lien in 1932 and that during the next six and one-half years the physical condition of the building deteriorated and the amount of the lien increased, are entirely inconclusive, particularly in the light of the buyer's willingness in 1938 to take subject to the increased lien and pay a substantial amount of cash to boot. Whatever may be the rule as to allowing depreciation to a mortgagor on property in his possession which is subject to an unassumed mortgage and clearly worth less than the lien, we are not faced with that problem and see no reason to decide it now.

At last we come to the problem of determining the "amount realized" on the 1938 sale. Section 111 (b), it will be recalled, defines the "amount realized" from "the sale . . . of property" as "the sum of any money received plus the fair market value of the property (other than money) received," and § 111 (a) defines the gain on "the sale . . . of property" as the excess of the amount realized over the basis. Quite obviously, the word "property", used here with reference to a sale, must mean "property" in

[32] See *Helvering* v. *Lazarus & Co.*, 308 U. S. 252; *Duffy* v. *Central R. Co.*, 268 U. S. 55, 61.

the same ordinary sense intended by the use of the word with reference to acquisition and depreciation in § 113, both for certain of the reasons stated heretofore in discussing its meaning in § 113, and also because the functional relation of the two sections requires that the word mean the same in one section that it does in the other. If the "property" to be valued on the date of acquisition is the property free of liens, the "property" to be priced on a subsequent sale must be the same thing.[33]

Starting from this point, we could not accept petitioner's contention that the $2,500.00 net cash was all she realized on the sale except on the absurdity that she sold a quarter-of-a-million dollar property for roughly one per cent of its value, and took a 99 per cent loss. Actually, petitioner does not urge this. She argues, conversely, that because only $2,500.00 was realized on the sale, the "property" sold must have been the equity only, and that consequently we are forced to accept her contention as to the meaning of "property" in § 113. We adhere, however, to what we have already said on the meaning of "property", and we find that the absurdity is avoided by our conclusion that the amount of the mortgage is properly included in the "amount realized" on the sale.

Petitioner concedes that if she had been personally liable on the mortgage and the purchaser had either paid or assumed it, the amount so paid or assumed would be considered a part of the "amount realized" within the meaning of § 111 (b).[34] The cases so deciding have al-

[33] See *Maguire* v. *Commissioner*, 313 U. S. 1, 8.

We are not troubled by petitioner's argument that her contract of sale expressly provided for the conveyance of the equity only. She actually conveyed title to the property, and the buyer took the same property that petitioner had acquired in 1932 and used in her trade or business until its sale.

[34] *United States* v. *Hendler*, 303 U. S. 564; *Brons Hotels, Inc.*, 34 B. T. A. 376; *Walter F. Haase*, 37 B. T. A. 948. See *Douglas* v. *Willcuts*, 296 U. S. 1, 8.

ready repudiated the notion that there must be an actual receipt by the seller himself of "money" or "other property", in their narrowest senses. It was thought to be decisive that one section of the Act must be construed so as not to defeat the intention of another or to frustrate the Act as a whole,[35] and that the taxpayer was the "beneficiary" of the payment in "as real and substantial [a sense] as if the money had been paid it and then paid over by it to its creditors." [36]

Both these points apply to this case. The first has been mentioned already. As for the second, we think that a mortgagor, not personally liable on the debt, who sells the property subject to the mortgage and for additional consideration, realizes a benefit in the amount of the mortgage as well as the boot.[37] If a purchaser pays boot, it is immaterial as to our problem whether the mortgagor is also to receive money from the purchaser to discharge the mortgage prior to sale, or whether he is merely to transfer subject to the mortgage—it may make a difference to the purchaser and to the mortgagee, but not to the mortgagor. Or put in another way, we are no more concerned with whether the mortgagor is, strictly speaking, a debtor on the mortgage, than we are with whether the benefit to him is, strictly speaking, a receipt of money or property. We are rather concerned with the reality that an owner of property, mortgaged at a figure less than that at which the property will sell, must and will treat the conditions of the mortgage exactly as if they were

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[35] See *Brons Hotels, Inc., supra*, 34 B. T. A. at 381.

[36] See *United States* v. *Hendler*, *supra*, 303 U. S. at 566.

[37] Obviously, if the value of the property is less than the amount of the mortgage, a mortgagor who is not personally liable cannot realize a benefit equal to the mortgage. Consequently, a different problem might be encountered where a mortgagor abandoned the property or transferred it subject to the mortgage without receiving boot. That is not this case.

his personal obligations.[38] If he transfers subject to the mortgage, the benefit to him is as real and substantial as if the mortgage were discharged, or as if a personal debt in an equal amount had been assumed by another.

Therefore we conclude that the Commissioner was right in determining that petitioner realized $257,500.00 on the sale of this property.

The Tax Court's contrary determinations, that "property", as used in § 113 (a) and related sections, means "equity", and that the amount of a mortgage subject to which property is sold is not the measure of a benefit realized, within the meaning of § 111 (b), announced rules of general applicability on clear-cut questions of law.[39] The Circuit Court of Appeals therefore had jurisdiction to review them.[40]

Petitioner contends that the result we have reached taxes her on what is not income within the meaning of the Sixteenth Amendment. If this is because only the direct receipt of cash is thought to be income in the constitutional sense, her contention is wholly without merit.[41] If it is because the entire transaction is thought to have been "by all dictates of common-sense . . . a ruinous disaster", as it was termed in her brief, we disagree with her premise. She was entitled to depreciation deductions for a period of nearly seven years, and she actually took them in almost the allowable amount. The crux of this case, really, is

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[38] For instance, this petitioner returned the gross rentals as her own income, and out of them paid interest on the mortgage, on which she claimed and was allowed deductions. See Reg. 77, Art. 141; Reg. 86, Art. 23 (b)-1; Reg. 94, Art. 23 (b)-1; Reg. 101, Art. 23 (b)-1.

[39] See *Commissioner* v. *Wilcox*, 327 U. S. 404, 410; *Trust of Bingham* v. *Commissioner*, 325 U. S. 365, 369–372. Cf. *John Kelley Co.* v. *Commissioner*, 326 U. S. 521, 527; *Dobson* v. *Commissioner*, 320 U. S. 489.

[40] *Ibid*; see also § 1141 (a) and (c), I. R. C.

[41] *Douglas* v. *Wilcutts*, *supra*, 296 U. S. at 9; *Burnet* v. *Wells*, 289 U. S. 670, 677.

whether the law permits her to exclude allowable deductions from consideration in computing gain.[42] We have already showed that, if it does, the taxpayer can enjoy a double deduction, in effect, on the same loss of assets. The Sixteenth Amendment does not require that result any more than does the Act itself.

Affirmed.

[42] In the course of the argument some reference was made, as by analogy, to a situation in which a taxpayer acquired by devise property subject to a mortgage in an amount greater than the then value of the property, and later transferred it to a third person, still subject to the mortgage, and for a cash boot. Whether or not the difference between the value of the property on acquisition and the amount of the mortgage would in that situation constitute either statutory or constitutional income is a question which is different from the one before us, and which we need not presently answer.

SUPREME COURT OF THE UNITED STATES

No. 68.—October Term, 1946.

Beulah B. Crane, Petitioner, *v.* Commissioner of Internal Revenue, Respondent.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[April 14, 1947.]

Mr. Justice Jackson, dissenting.

The Tax Court concluded that this taxpayer acquired only an equity worth nothing. The mortgage was in default, the mortgage debt was equal to the value of the property, any possession by the taxpayer was forfeited and terminable immediately by foreclosure, and perhaps by a receiver *pendente lite*. Arguments can be advanced to support the theory that the taxpayer received the whole property and thereupon came to owe the whole debt. Likewise it is argued that when she sold she transferred the entire value of the property and received release from the whole debt. But we think these arguments are not so conclusive that it was not within the province of the Tax Court to find that she received an equity which at that time had a zero value. *Dobson* v. *Commissioner*, 320 U. S. 489; *Commissioner* v. *Scottish American Investment Co., Ltd.*, 323 U. S. 119. The taxpayer never became personally liable for the debt, and hence when she sold she was released from no debt. The mortgage debt was simply a subtraction from the value of what she did receive, and from what she sold. The subtraction left her nothing when she acquired it and a small margin when she sold it. She acquired a property right equivalent to an equity of redemption and sold the same thing.

It was the "property" bought and sold as the Tax Court considered it to be under the Revenue Laws. We are not required in this case to decide whether depreciation was properly taken, for there is no issue about it here.

We would reverse the Court of Appeals and sustain the decision of the Tax Court.

MR. JUSTICE FRANKFURTER and MR. JUSTICE DOUGLAS join in this opinion.